Iowa Utilities Board
Policy, Energy, and Customer Services Sections

Docket No.: RPU-2009-0002
Utility: Interstate Power and Light Co.
Memo Date: December 1, 2009

TO: The Board

FROM: RPU-2009-0002 Team

SUBJECT: Post-Hearing Memo

Briefing scheduled for December 9, 2009
Decision Meeting scheduled for December 21, 2009

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Introduction and Procedural History

On March 17, 2009, Interstate Power and Light Company (IPL or Company) filed with the Utilities Board (Board) proposed electric tariffs, identified as TF-2009-0048 and TF-2009-0049. In TF-2009-0049, IPL proposed a temporary annual increase in its Iowa retail electric revenue of approximately $84 million, or 7 percent over current Iowa retail electric revenue. Pursuant to Iowa Code § 476.6(10), IPL implemented its proposed temporary rates ten days after its March 17, 2009, filing; the rates are subject to refund. In TF-2009-0048, IPL proposed a permanent annual increase in its Iowa retail electric revenue of approximately $171 million, or about 16.6 percent over its current revenues.

The Board docketed IPL's filing as Docket No. RPU-2009-0002 and set a procedural schedule by order issued April 13, 2009. In addition to the Consumer Advocate Division of the Department of Justice (Consumer Advocate or OCA), Ag Processing Inc., the Large Energy Group (LEG), and the Iowa Consumers Coalition (ICC) intervened in the proceeding. The LEG consists of 24 major IPL customers, largely in the former Iowa Electric territory. The ICC consists of six large customers from the former Iowa Southern and Union Electric territories.

The Board held seven consumer comment hearings throughout IPL's service territory. Prefiled testimony was submitted by all intervenors.

In its rebuttal testimony, IPL reduced its request for final rates to approximately $146 million. Consumer Advocate's rebuttal testimony reduced its rate reduction request to about $30 million; its original proposal was for a $50 million reduction. The changes were the result of some issues being agreed to or dropped by the two parties. One of the major differences in IPL's request and Consumer Advocate's recommendation is Consumer Advocate's request that a management efficiency penalty be imposed. IPL's sale of its transmission system to ITC Midwest forms part of the basis for Consumer Advocate's management inefficiency recommendation.

Although not part of the rate case filing, the Board on September 9, 2009, approved IPL's fourth-step equalization tariff in Docket No. TF-2009-0143. Originally set to become effective on June 30, 2009, the fourth-step was delayed so that it could be revised to reflect temporary rates in the rate case. The fourth step was effective September 16, 2009, which coincided with the switch from summer to winter electric rates. Only one equalization step remains for residential and general service classes. Equalization was completed in 2008 for the large general service and lighting classes.

A hearing was held beginning October 5, 2009. Simultaneous initial and reply briefs have been filed by the parties. The statutory 10-month decision deadline is January 17, 2010. Because this falls on a Sunday and Martin Luther King Day is

the following day (January 18), the deadline is technically January 19, 2010. However, the Board has traditionally tried to issue orders by the Friday before (January 15) when a deadline falls on a Sunday or Monday holiday.

The primary drivers for IPL's rate case filing include capital costs related to the 2008 floods and transmission costs from ITC Midwest, LLC (ITC), as well as overall increases in expenses since IPL's last electric rate case, which used a 2003 test year. While IPL is not seeking a management efficiency bonus, management inefficiency became an issue in this proceeding when Consumer Advocate proposed a $50 million reduction to revenues because of IPL's management inefficiency.

Background of Management Efficiency/Inefficiency Proceedings

Iowa Code § 476.52 deals with management efficiency. The statute provides:

1. That it is the policy of the state that a public utility shall operate in an efficient manner.

2. In a rate case proceeding, if the Board determines that a utility is operating in an inefficient manner, or is not exercising ordinary, prudent management, or in comparison with other utilities in the state the utility is performing in a less beneficial manner than other utilities, the Board may reduce the level of profit or adjust the revenue requirement of the utility to provide incentives to the utility to correct its inefficient operation.

3. In a rate case proceeding, if the Board determines that a utility is operating in such an extraordinarily efficient manner that tangible financial benefits result to the ratepayer, the Board may increase the level of profit or adjust the revenue requirement for the utility. Energy efficiency programs may be considered.

4. The statute also provides that the Board shall adopt rules for determining the level of profit or the revenue requirement adjustment that would be appropriate and also that the Board shall adopt rules establishing a methodology for an analysis of a utility's management efficiency.

When rules were initially adopted regarding management efficiency in the mid-1980's, much of the focus was on annual management efficiency reports that the utilities were required to file. The reports were designed to provide a basis for utility-to-utility comparisons. However, prior Boards found that comparisons to other utilities in the state were of limited value because of differences in service territories, customer mix, weather patterns and disasters, and other factors. The current management efficiency rules (last revised in 1997) provide that "[t]he efficiency or inefficiency of a utility will be evaluated on a case-by-case basis, based upon the utility's particular facts and circumstances," as well as noting that management efficiency does not lend itself to an absolute measure. 199 IAC

29.3(1). In evaluating management efficiency, 199 IAC 29.3(1) lists several factors the Board may consider, including price per unit of service, operation and maintenance costs per unit of service, quality of service, executive compensation, fuel costs, utility-wide load factors, innovative ideas implemented by management, and bad debt ratio. This information used to be required in the annual management efficiency reports; the current rule provides that the Board can request that information at its discretion. In the order adopting the 1997 revisions and rescinding the annual report requirement, the Board said:

> The Board intends to continue closely scrutinizing management efficiency. The adopted amendments are simply recognition that the management efficiency reports are not, in many cases, a useful tool to determine management efficiency or inefficiency. Also, much of the information contained in these reports is duplicated in other regulatory filings. The Board's limited resources can be better applied in other areas and in focusing on a particular utility's unique attributes which, judging from prior cases, are a better determinant of management efficiency. In re: Management Efficiency, "Order Adopting Rules," Docket No. RMU-97-2 (10/17/1997).

In determining whether a utility is run well or poorly, the Board is not limited to test year data. 199 IAC 29.4. The rule provides for an upward adjustment to return on equity for an exceptionally managed utility, and a downward adjustment to return on equity for a poorly managed utility. Finally, the rule provides that the Board will not establish any reward or penalty if the utility has been managed satisfactorily but not exceptionally well or poorly, because satisfactory management is expected from all public utilities.

In cases where adjustments to return on equity have been made, the adjustment is reflected as a separate item on the schedules and is not used for calculating allowance for funds used during construction or other regulation purposes. Some examples of past rate cases where an upward adjustment for management efficiency was made are:

IPS Electric, a Division of Iowa Public Service Company, Docket No. RPU-91-6 (6/1/1992). An upward adjustment of 30 basis points to the return on equity was made to reflect extraordinary management efficiency that resulted in tangible benefits to ratepayers. The benefits were related to the merger of holding companies and subsequent corporate restructuring.

Iowa Southern Utilities Company, Docket No. RPU-91-8 (7/13/1992). An upward adjustment of 150 basis points was made to return on equity based on several

factors, including Iowa Southern's low prices, general frugality, and specific costs savings with respect to generation plants.

U S West Communications, Inc., Docket No. RPU-93-9 (6/17/1994). An upward adjustment of 75 basis points to the return on equity was made. The award was based on U S West's response to the 1993 flood, merger savings, and savings from an employee reduction that the Board said was done in a responsible manner.

While the statute provides that a management efficiency reward or penalty can either be made to return on equity or the revenue requirement, the Board's rules only address adjustments to return on equity.

It is an open question whether a management efficiency reward or penalty can be implemented by either a return on equity or revenue requirement adjustment. Section 476.53 requires that the Board adopt rules for the level of profit or revenue requirement adjustment. Because there are no rules with respect to a revenue requirement adjustment, there is an argument that the Board must use the return on equity adjustment. IPL raised this argument in its initial brief at page 9. If the Board decides to impose a management efficiency penalty, one option would be to give IPL a choice. For example, Consumer Advocate's proposed management efficiency penalty of $50 million translates into an approximate 380 basis points reduction in IPL's ROE. (Tr. 1095). Whatever the amount of penalty, the Board could allow IPL to take it either as a revenue requirement adjustment or return on equity reduction. Staff recommends consideration of this option only if the Board imposes a substantial penalty. If the penalty is relatively small, staff would recommend imposing it pursuant to the rule, as a return on equity reduction.

State commissions, including Iowa, have addressed management efficiency issues and imposed penalties for inefficient management. Some jurisdictions have a specific management efficiency statute and others address management efficiency issues under the just and reasonable rates standard. In the cases staff reviewed, rate comparisons play little (if any) role in management efficiency decisions, and are often directed at specific decisions management has made.

Management efficiency reward/penalty cases appear to have been most popular in the 1980's. The Iowa Board imposed a 1 percent reduction (100 basis points) in Great River Gas Company's return on equity, which resulted in a reduction in rate base of about $20,000, in an order issued on April 3, 1986, in Docket No. RPU-85-16. The Board was critical of Great River for signing a 20-year supply contract where Great River agreed to pay demand charges for that period of time with no exit for changing conditions. The Board was generally critical of Great River's supply planning because while it planned for growth it expected the Board to protect it from losses. The Board did not disallow the costs of the contract, however, because the contract was not imprudent when entered into—the

criticism was directed at Great River's supply planning in general and the lack of an escape clause in the contract. Rate comparisons between utilities were not an issue.

The Iowa Board imposed a 1 percent reduction (100 basis points) on Iowa Gas Company's return on equity, which translated to a reduction in rate base of about $250,000, in an order issued June 27, 1986, in Docket No. RPU-85-22. Here, the Board compared Iowa Gas to other Iowa gas utilities and found the company deficient, particularly with respect to the quality of its service because of the large number of complaints regarding reading meters and lack of responsiveness to customers. However, rate comparisons did not play a role in the penalty.

In an order issued in April 1998, the Texas Commission reduced Entergy Gulf States, Inc. return on equity by 60 basis points in PUC Docket No. 18249. The Commission said the record revealed a lack of effective and prudent maintenance policies (focused on the distribution system with deficiencies in pole inspection and vegetation management), uneven spending in the areas of operations and maintenance, cuts in experienced personnel, and deterioration of service quality. Going forward, Entergy could make back some of the reduction by meeting specific benchmarks. Rate comparisons with other utilities were not an issue.

The Vermont Supreme Court upheld the Commission's 525 basis point reduction in return on equity for a Vermont utility in Citizens Utilities Company, 769 A.2d 19 (2000). The Court noted the record was replete with examples of inadequate and misleading accounting practices that obscured the true nature of the utility's expenditures and activities, failure to comply with demand-side management obligations, failure to implement least-cost planning for transmission and distribution facilities, failure to obtain necessary Board approval prior to converting distribution lines to transmission lines, and resisting the Commission's efforts to obtain information about the utility's activities. The Court noted the return on equity reduction was not to penalize the company for certain conduct, but rather to set reasonable rates in cases where the consumers are not being adequately served due to inefficiency or improvidence or other like reasons. The Court rejected constitutional arguments that the rate of return reduction was confiscatory. Vermont did not have a management efficiency statute like Iowa's but had the just and reasonable rate standard in its statute. Once again, rate comparisons were not an issue.

The North Dakota Commission in Otter Tail Power Company, 53 PUR 4th 296, 310 (1983) reduced Otter Tail's return on equity by 1 percent (100 basis points) where the utility was found deficient in controlling its rates (a large wage increase was cited). Also, the Commission cited a decline in capital costs and the inflation rate from the time of the rate application to the time of the Commission's order as supporting the reduction. This was done under the just and reasonable rate

standard and not a specific management efficiency statute. No rate comparisons were made.

Background on ITC-Midwest and Related Issues

Consumer Advocate proposes to disallow all ITC transmission costs that exceed the estimates presented in Docket No. SPU-07-11, the reorganization docket involving the sale of IPL's transmission assets to ITC, arguing that to do otherwise would be to allow IPL to ignore its commitments. (Tr. 76). IPL disagreed, saying that the commitments made in that docket were not designed to shield customers from cost increases due to ITC's grid expansion or actual operations and maintenance and administrative and general expenses.

The ITC transmission rate approved by the Federal Energy Regulatory Commission (FERC) is based on projected costs, with a subsequent true-up. The ICC objected to recovery of projected costs as violating the known and measureable standard.

The Board no longer has rate authority over IPL's transmission costs because FERC has exclusive jurisdiction over wholesale rates. Several state courts have held that a state utility commission setting retail rates must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price, basing their decisions on the filed rate doctrine; such state decisions have been approved by the U.S. Supreme Court. Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 966 (1986). Consumer Advocate's and ICC's proposals would in effect require IPL to sell the transmission service it purchases to retail customers at less than the cost it paid, as determined by FERC. Under Nantahala, not allowing recovery of costs pursuant to a FERC-approved rate is called "trapping" costs and is prohibited. 476 U.S. at 969. When that FERC-approved rate includes projected costs (subject to true-up), it is part of a FERC-approved tariff and the state commission must allow recovery. United Gas Corp. v. Mississippi Pub. Ser. Comm'n, 127 So.2d 104 (Miss. 1961).

While the Board must allow recovery of the FERC-approved rate, there is no requirement that an automatic recovery mechanism must be approved. The Board could find that an automatic adjustment is not appropriate in this case because it could reduce IPL's incentive to vigorously participate in FERC proceedings in which ITC's transmission rates are set. In addition, if the Board believes IPL violated its commitments in the ITC case, possible remedies include a civil penalties proceeding or using management efficiency adjustment as a vehicle to give customers the benefit of the commitments. To mitigate the increases in the short-term, IPL has also proposed accelerating the use of the proceeds from the transmission sale that were to be used over a multi-year period to mitigate impacts to customers.

Memo Format

This memo is organized in the same manner as the prehearing memo. The issues are in the same order and include: rate base, income statement, transmission, cost of capital, and rate design issues. Each issue summarizes the initial and reply briefs and is followed by staff's analysis and recommendations. For some issues, recommendations may include several options with reasoning for each. The uncontested issues from the prehearing memo are not included in this memo.

Rate Base Issues

Cash Working Capital

IPL Initial

Initial Brief: pp. 60-62

IPL developed its cash working capital requirements based on a lead lag study that calculated a total 42.5 day lag between the rendering of service and the receipt of payment for service. The 42.5 day lag consists of a 15.3 day metering period lag, a 2.9 day bill processing lag, and a 24.3 day collection period lag. (Tr. 495)

Both the Consumer Advocate and the ICC recommended that the collection period be calculated at no longer than 20 days. They noted that customer bills are due 20 days after the company billing date according to rate tariffs, and maintained that IPL would be reimbursed for any bills beyond the 20 days through the collection of a late payment fee. (Tr. 1161, 1879)

Neither the Consumer Advocate's nor the ICC's adjustments acknowledged that IPL allows a four-day grace period for customer bill payment. This grace period allows for mail delivery lag which was previously not an issue when IPL had more geographically prevalent commercial offices for walk-in payment (Tr.543), and avoids unnecessary customer disputes. (Tr. 471-472) The concept of a customer bill payment grace period is considered an industry standard practice. (Tr.544) Also, IPL has consistently conducted its lead lag studies with the grace period's inclusion. (Tr. 471)

If IPL was held strictly to the 20-day billing cycle, it may examine the possibility of opening local offices for walk-in payments, or find other viable means to help customers avoid penalty assessments because of mail lag. As a result, IPL has calculated and provided the approximate $1.6 million adjustment to reflect these cost increases. (Tr. 545-546) The Consumer Advocate's and the ICC's proposed adjustments are both erroneous and incomplete.

Another important consideration is the current Iowa Administrative Code requirements that require periodic late payment forgiveness. One requirement provides that all electric utilities grant customers on first payment agreement forgiveness of at least one late payment that is made four days or less after the due date. Another requirement is that an electric utility forgive at least one payment penalty for each electric service account annually. IPL's existing payment and collection systems are integrated; payment due dates trigger steps in the collection process, including the default payment agreements. Requiring IPL to discontinue the four-day grace period will require readjustment of its payment and collection system, which is not a simple task. Continuing the four-day grace period will allow IPL to remain in compliance with the Iowa Administrative Code without the extra cost of re-coding its computer systems or developing methods of manually segregating these accounts.

To strictly enforce the 20-day billing cycle would lead to increased customer complaints, late payment issues and would not be "customer focused."

Consumer Advocate Initial

Initial Brief: pp. 40-42

Consumer Advocate witness Henry testified that the 24.3-day collection period was incorrect. The use of a 24.3-day collection period proposed by IPL implies on average that all customer bills are paid an average of 4.3 days beyond the customer due date, *i.e*., 20 days after IPL's billing date. IPL is fully reimbursed for customer bills paid beyond the due date through the collection of a late payment fee. To the extent IPL's 24.3-day collection period lag is partially the result of the extraordinary June 2008 flood, this is a nonrecurring event and is unlikely to occur in the future. Electric rates should be set to reflect normal and representative conditions, not aberrations such as the 2008 flood. (Tr. 1160-61)

IPL already compensated through late payment fees for bills paid after the 20-day period. These fees are included in the account receivable amounts utilized in IPL's 24.3-day number are unpaid accounts that are ultimately expensed to uncollectible accounts expenses that are already allowed and included in IPL's base rates. (Tr. 1161)

ICC witness Gorman provided similar testimony on this issue. (Tr. 1878-79)

IPL witness Hampsher, in rebuttal, stated that if the Board found the tariff 20-day collection period appropriate, IPL would likely change its collection

practice to 20 days and would eliminate the four-day grace period. An additional revenue adjustment of $1.6 million would need to be made to reflect additional late payment fee revenue not collected during the test year due to this change in IPL's collection practices. (Tr. 470-71) At hearing, IPL witness Hampsher referred to an alleged and unsupported expense increase. (Tr. 545-546)

Consumer Advocate witness Henry testified in rebuttal that in IPL's last litigated electric rate case, Docket No. RPU-02-3, the Board allowed 21.9 days for the revenue collection period. Other cases cited by IPL were settled cases and are of no precedential value. (Tr. 1163-64)

Ms. Henry also stated that Mr. Hampsher's rebuttal adjustment of $1.6 million to increase revenues for additional late payment fees if IPL eliminates the four-day grace period is actually an adjustment to increase expenses which would increase, not decrease, the revenue requirement. Any proper adjustment would increase revenues, not expenses. It appears Mr. Hampsher's $1.6 million adjustment would reflect Consumer Advocate's and ICC's 20-day collection period, but IPL's revenue requirement would reflect the result as if IPL's 24.3-day collection period number was used. (Tr. 1166-67)

Ms. Henry concluded that the Board should simply decide whether 20 days or 24.3 days should be utilized for the revenue collection period. Mr. Hampsher's rebuttal adjustment of $1.6 million should be entirely rejected. Based on the evidentiary record, the Board should adopt a 20-day revenue billing lag day's period in this proceeding.

ICC witness Gorman made similar points in his rebuttal testimony. (Tr. 1903-904)

ICC Initial

Initial Brief: pp. 14-15

IPL inflated its cash working capital needs by assuming that all customers will pay their bills later than required by its tariff. IPL's proposal is based on a revenue collection period of 24.3 days. This approach is unsupported by the terms of IPL's tariff and unfairly penalizes customers. IPL's proposal is contrary to the Rules and Regulations for Electric Service set forth in its tariff, which requires customers to pay bills within 20 days before incurring a penalty. There is no reasonable justification to collect delinquency costs in the cost of service rather than from the individual delinquent customer. IPL's revenue lag should be reduced from 24.3 days to 20 days, which will reduce IPL's cash working capital component of rate base from ($7,123,803) to ($19,510,828), which requires an adjustment to

the proposed rate base of $12,387,025 and decreases IPL's claimed revenue deficiency in this case by $1.48 million.

IPL Reply

Reply Brief: p. 8

IPL believes that it has thoroughly and adequately addressed the issue of the appropriate number of revenue lag days. IPL reiterates that current Iowa Administrative Code requirements require periodic late payment forgiveness.

Requiring IPL to discontinue the four-day grace period will require significant readjustment of its computer programming payment and collection system. In the alternative, IPL would have to develop some method to manually review all payments that fall outside the current grace period to determine whether they complied with the late payment provisions found in the Iowa Administrative Code. Either method would require significant expenditures of time, funds, and labor.

Consumer Advocate Reply

Reply Brief: pp. 12-13

IPL, in its initial brief at pages 61-62, makes a post-hoc rationalization concerning IPL witness Hampsher's $1.6 million revenue adjustment. Throughout this proceeding until hearing, the $1.6 million revenue adjustment was purportedly to increase revenues to reflect additional late payment fee revenue not collected during the 2008 test year. (Tr. 470-71) However, Mr. Hampsher's $1.6 million revenue adjustment is actually an adjustment to increase expenses which would increase, not decrease, the revenue requirement. (Tr. 1166-67)

Having been confronted with this, he totally changed his position at hearing and made the post-hoc rationalization for the first time in this proceeding that IPL might have some undefined increase in cost to account for the four-day grace period. (Tr. 545-46) IPL continues this disingenuous argument in its initial brief.

In light of the above, the Board should use 20 days for IPL's collection period and disallow IPL's $1.6 million mislabeled revenue adjustment. (Tr. 1160-61, 1166-67, 1878-79, 1903-904)

ICC Reply

Reply Brief: pp. 8-9

IPL fails to present any reasonable justification for its approximate $1.48 million adjustment. The adjustment would penalize the majority of IPL's customers who pay their bills on time by inflating IPL's revenue requirement. IPL's tariff clearly states that customers must pay their bills within 20 days or they will be penalized.

IPL cites to 199 IAC § 20.4(11)"c"(4) and 199 IAC § 20.4(12)"d" as requiring periodic late payment forgiveness. However, the regulations do not require routine late payment forgiveness. IPL's proposal, by calculating a collection period of 24.3 days, is contemplating that every single customer will be late paying every single bill. This is an implausible result given the express terms of IPL's rules and the apparent lack of common knowledge among customers that this lag period even exists. (Tr. 544) IPL's claimed revenue deficiency should be lowered by $1.48 million.

Staff Analysis

IPL's lead-lag study shows 24.3 days in the collection period. However, the year 2008 may not have been a representative year because of the flood and the economy.

IPL's electric tariff provides that bills must be paid within 20 days of the billing date. Any delinquent bill can have a late payment charge assessed. IPL allows a four-day grace period to avoid disputes. If IPL eliminated the four-day grace period, it would be difficult or perhaps not possible to determine the amount of forfeited discount revenue that IPL would collect. But if IPL had assessed penalty revenue after 20 days, the test year revenue would have been higher, which means that the revenue requirement would have been lower.

Consumer Advocate and ICC argue that the Board should allow a 20-day collection period. The Board allowed 21.9 days for the revenue collection period in IPL's last litigated electric rate case, RPU-02-3. Other cases cited by IPL cannot be used for precedence since they were settled cases.

Also, witness Hampsher proposed a $1.6 million adjustment if the Board decides to allow 20 collection period days instead of 24.3 days. The $1.6 million would reflect the cost increases of opening local offices or finding ways to help customers avoid penalties because of mail lag. If the Board allows 20 days instead of 24.3 days, the revenue requirement would decrease by approximately $1.6 million. However, if the Board then allows witness Hampsher's proposed adjustment, expenses would increase by $1.6 million, the test year revenue would decrease accordingly, and the revenue requirement would increase by $1.6 million.

As Consumer Advocate noted, the revenue requirement would reflect the result as if IPL's 24.3-day collection period number was used.

Staff Conclusion

Staff believes that a fair method would be to split the difference between IPL's and Consumer Advocate/ICC's positions and allow 22 collection period days. The revenue requirement would be increased by approximately $800,000 by allowing 22 days instead of 20 days. If the Board allows 24.3 days, the revenue requirement will be approximately $1.6 million higher than if the 20-day collection period is allowed.

Staff does not believe that IPL's proposed adjustment to increase expenses by $1.6 million should be allowed if the Board allows less than 24.3 days. The cost for delinquent customers would be shifted to all of the company's customers through the cost of service if the adjustment is allowed. This does not seem to be a fair way to recover the delinquency cost. Customers that do not pay their bill within 20 days should be responsible for paying the delinquency cost. In addition to the late payment fee that IPL can collect, the company also has uncollectible accounts expense included in their base rates.

Income Statement Issues

Salaries and Wages

IPL Initial

Initial Brief: pp. 63-65

While the Consumer Advocate accepted many of IPL's standard salaries & wages (S&W) adjustments, the Consumer Advocate made one additional adjustment that IPL believes is unnecessary and inappropriate. The Consumer Advocate recommended the exclusion of $1,280,761 related to IPL's enhanced 401(k) matching plan for its employees. (Tr. 434, 1126-1128, 1147) The Consumer Advocate excluded this amount, is "above and beyond" IPL's 401(k) contribution for the 2008 test year, is "based upon an expected employer contribution increase for calendar 2009 which has not occurred," and is "based at an employee level much less than in 2008." (Tr. 1134)

The 401(k) match was in full force and effect through June 2009. It was only in June that the 401(k) match was temporarily suspended. While the Consumer Advocate has argued that there is no guarantee the 401(k) match will be reinstated, the Board of Directors resolution suspending the matching levels

specifically included a sunset provision stating that the suspension would lapse by year end 2009. (Consumer Advocate Exhibit FK-2, Confidential Schedule A.) All affirmative action required from the Board of Directors has been taken for the suspension to lapse and the enhanced 401(k) matching will be reinstated by 2010.

Only 38 employees allocable to the Iowa electric operations of IPL's 1,970 total employees, or 1.9 percent, were directly affected by the workforce reduction. (Tr. 1149) Rounding that figure to two percent, and applying that two percent to the total IPL contribution to the 401(k) match, then halving that amount to approximate a one-half year suspension of the matching funds, demonstrates that effectively only $45,058 is actually at issue. (Tr. 1149-1150) In other words, only $45,058 of the enhanced 401(k) match may even arguably be subject to exclusion in this docket, not $1,280,761 as contended by the Consumer Advocate.

Consumer Advocate Initial

Initial Brief: pp. 30-33

Consumer Advocate did not accept IPL's proposed adjustment of $1,280,761 for an enhanced 401(k) plan, which was above and beyond the contribution for 2008 test year. IPL's workforce reduction calculation does not reflect the recently announced cuts in 401(k) and employee furloughs. Based upon these facts, IPL's proposed 2009 increase for an enhanced 401(k) plan will not materialize. Therefore, IPL's pro forma adjustment for an enhanced 401(k) plan is unnecessary, and if allowed by the Board, would charge customers for expenses IPL did not incur during the test year and would not incur in 2009. (Tr. 1127-28) In Consumer Advocate Exhibit 102, it asked IPL to document any enhanced 401(k) contributions by IPL in 2009. It is clear from IPL's response that there were no enhanced 401(k) contributions that were actually made in 2009. Rather, IPL simply stated that its entire response started from the basis of IPL's portion of ***2008*** guaranteed match on 401(k) employee matching contributions. No enhanced 401(k) contributions for 2009 were identified.

ICC Initial

Initial Brief: p. 15

ICC has no objection to the adjustments proposed by Consumer Advocate on the issue of salaries and wages.

IPL Initial

Reply Brief: pp. 9-11

IPL may have inadvertently created some confusion between what it has been calling its 401(k) match and its enhanced 401(k) plan.

To clarify, IPL has one 401(k) plan. The Company makes two types of contributions to this plan for employees. First, IPL makes a cash contribution regardless of employees' contributions to their 401(k). This is in lieu of a five percent benefit credit previously made to the Cash Balance Pension Plan. This has been referred to as the "enhanced" plan, and was effective starting in August 2008. (Tr. 346) This contribution has remained in effect throughout all of 2009 (the "on-going contribution").

IPL also matches employee contributions. The 401(k) match is a component of the 401(k) plan. This part of the Company's contributions was temporarily suspended in June of 2009.

For purposes of this reply brief, IPL will refer to the on-going contribution as the "enhanced plan." The matching contributions will be referred to as the "401(k) match."

The Consumer Advocate's recommended exclusion of the $1,280,761 relates to IPL's enhanced 401(k) plan for its employees, which primarily relates to the cash contribution which began in August 2008. Some of this confusion stems from the Consumer Advocate's initial confusion between the 401(k) match component and the new cash contribution component of the 401(k) plan (the “enhanced” feature). In its recommended exclusion of the $1,280,761, the Consumer Advocate stated that these enhanced levels have not in fact occurred in 2009. However, the Consumer Advocate has confused the enhanced 401(k) plan with the 401(k) match.

First, Consumer Advocate continues to contend that because of the workforce reduction, the number of employees available to participate in the enhanced 401(k) is "much less" (Tr. 1126-1128) and, therefore, "IPL's proposed 2009 increase for an enhanced 401(k) will not materialize." IPL concurs that the enhanced 401(k) adjustment was not refined to reflect the impacts of the workforce reduction. But as demonstrated in its Initial Brief (IPL 64-65), refining the effects of the workforce reduction on the enhanced 401(k) in consideration of the proper allocations results in an adjustment of only $45,058. (Tr. 1149-1150)

The Consumer Advocate also continues to assert, even after examination of irrefutable evidence, that the enhanced 401(k) "was not shown to be established in 2009." (Consumer Advocate Brief p. 32) This assertion ignores IPL's clear demonstration that the enhanced 401(k) plan was indeed in place and in full effect beginning in August 2008 and through the end of the test year (Tr. 345), as acknowledged by the Consumer Advocate's own witness (Tr. 1146), and that the

enhanced 401(k) continues to be in full force and effect throughout 2009. (Consumer Advocate Exhibit FK-2, Confidential Schedule A)

Consumer Advocate Reply

Reply Brief: p. 10

IPL, in its initial brief at pages 63-67, argues there was a post-test year increase for an enhanced 401(k) plan of $1,280,761. This argument is without merit. Consumer Advocate Exhibit 102 shows there was no post-test year increase whatsoever for an enhanced 401(k) plan.

ICC Reply

Reply Brief: p. 10

ICC maintains its original position with respect to salaries and wages.

Staff Analysis

The only contested issue is IPL's Enhanced 401(K) employer contributions of $1,280,761. IPL stated that the enhanced 401(k) plan was in full force and effect throughout 2009. It was not the enhanced 401(k) plan, but rather the 401(k) match that was temporarily suspended in June 2009.

Consumer Advocate noted that IPL is asking to charge customers for expenses that they did not incur during the test year and will not incur in 2009. In fact, with the workforce reduction, the 401(k) contribution in the future will be based at an employee level that is less than what was in place in 2008.

IPL concurs that the enhanced 401(k) adjustment was not refined to reflect the impacts of the workforce reduction but the proper allocation results in an adjustment of only $45,058.

IPL contends that the Consumer Advocate has readily accepted annualized S&W adjustments in the past.

Staff would recommend that the Board allow IPL's Enhanced 401(K) employer contributions of $1,235,703 ($1,280,761 less the workforce reduction adjustment of $45,058).

Pension Expense

IPL Initial

Initial Brief: pp. 67-68

IPL submitted a 2009 pension cost estimate based upon an actuarial study done by Towers Perrin. (TP) (Tr. 436) Consumer Advocate expressed concern that the pension estimate may be speculative and proposed instead a two-year average of 2008 and 2009 costs. (Tr. 436, 1176) IPL concluded that, due to the impacts of "the economic recession of the stock market and the resulting reduction in the value of pension plan assets," the TP study may in fact be overstated. IPL therefore agreed that an averaging method may be appropriate in this particular situation. IPL disagreed, however, that a two-year average was sufficient. (Tr. 437)

A five-year inflation-adjusted average would be consistent with many of IPL's other adjustments where it has been deemed appropriate to levelize year-to-year fluctuations. (Tr. 437-438) As a result, assuming that the correct figures are employed in the calculation of the pension costs. (Tr. 439) and a five-year inflation-adjusted average is employed, IPL will move away from the TP study as the basis for pension costs in this case.

Consumer Advocate Initial

Initial Brief: pp. 35-39

IPL witness Hampsher adjusted the 2008 test year for increases in pension expense, calculated pursuant to SFAS No. 87 determined by actuary TP and allocated to IPL's Iowa electric operations. The primary reason for the increase was related to the significant decline in the value of plan assets in 2008. The original amount of the pension adjustment was $14,086,322. (Tr. 349-50)

There were no significant changes to any IPL Iowa electric operations related pension plans which would account for the huge increase in pension expense from 2008 to 2009. The primary driver of the huge increase in IPL's pension expense from 2008 to 2009 appeared to be the roughly 35-40 percent decline in most major stock indices that occurred in 2008 but not meaningfully incorporated into the derivation of IPL's estimated pension expense until 2009 (Tr. 1175-76) Mr. Hampsher agreed (Tr. 349). IPL's pension adjustment should be rejected by the Board because it is speculative and unrepresentative. (Tr. 1176)

For ratemaking purposes, Mr. Condon recommended the use of an average of 2008 and 2009 pension expense, which results in a $7,043,161 increase to 2008 test year levels. (Tr. 1176)

An average of 2008 and 2009 was more appropriate than simply relying on the actuary's estimate for 2009 as it would be unfair and unjustified to charge IPL's ratepayers an additional approximately $7 million dollars (IPL's pension

adjustment of $14,086,322 less OCA's pension adjustment of $7,043,161) when it is fairly likely that the stock market will eventually rebound. (Tr. 1176)

IPL witness Hampsher filed rebuttal testimony that stated IPL believes that establishing rates based upon 2009 projections, which are relatively high due to the impacts of the economic recession on the stock market and the resulting reduction in the value of pension plan assets, may result in unreasonably high pension costs that will likely not be sustained as the economy and stock market recovers. Mr. Hampsher therefore recommended five-year inflation adjusted average of pension costs in lieu of Mr. Condon's two-year average and provided his rationale for doing so. (Tr. 436-39)

The cross-examination of Mr. Hampsher clearly established that the two-year period was not only more appropriate, but necessary. Mr. Hampsher acknowledged that for several years of his five-year averages, there were IPL DAEC employees included who no longer worked for IPL. Further, Mr. Hampsher acknowledged that for several years of his five-year average, there were IPL transmission employees included who no longer worked for IPL. Finally, Mr. Hampsher acknowledged that he never adjusted earlier years within his five-year average for pension changes that occurred in later years in his five-year average. (Tr. 503-504, 557-59).

Based upon the evidentiary record, Mr. Condon's two-year average should be adopted by the Board.

IPL Reply

Reply Brief: pp. 12-13

IPL believes it has adequately discussed the majority of the issues raised by the Consumer Advocate in its Initial Brief regarding the proposed Pension Cost adjustment. However, one matter in particular bears further clarification. Consumer Advocate maintains that its two-year average for this adjustment is more appropriate than IPL's five-year inflation-adjusted adjustment because IPL's five-year period will incorrectly include DAEC employees and transmission employees no longer employed by IPL. (OCA Brief p. 39)

Consumer Advocate notes that certain DAEC and ITC employees may no longer be with the IPL without addressing whether these employees have been replaced; without examining whether other workforce amplifications were occurring at the same time; and without ever putting a number on the employees lost or quantifying the difference in Pension Costs this difference creates. Additionally, the Consumer Advocate waited until hearing to make these assertions, allowing IPL to present no evidence of any offsetting factors.

Regardless, the point of IPL's five-year inflation-adjusted average is not to capitalize on prior employees, but to even out undue fluctuations that would not be appropriate smoothed over by a two-year average. (Tr. 438) The Consumer Advocate's adjustment and IPL's adjustment do not significantly differ. IPL is concerned with the precedential value of adopting the Consumer Advocate's two-year average, and the improperly levelized effect that adoption could have in the future.

Consumer Advocate Reply

Reply Brief: pp. 11-12

IPL argues that a five-year average is preferable to a two-year average; however IPL's five-year average included several years that included DAEC and transmission employees who no longer work for IPL. The drop in value of IPL's pension plan assets due to the recession is not permanent. The stock market has already significantly recovered. (Tr. 1176) The use of two-year average for pensions is more in line with what IPL has experienced in the past and will experience in the near term.

Staff Analysis

The proposed pro forma adjustment for Pension Expense by IPL is based on the decline in the value of plan assets during 2008. Staff agrees with Consumer Advocate that that the drop in value of IPL's pension plan assets is not permanent, as IPL's original adjustment would assume.

IPL's argument that five-year inflation adjusted average is a superior method to capture fluctuating costs than is a two-year average only proves that the longer period of more years will reduce the variability of the average.

Mr. Hampsher acknowledged that for several years of his five-year average, there were IPL DAEC and transmission employees included who no longer worked for IPL. There are no offsetting factors provided in the record.

Finally, IPL witness Hampsher stated that a two year average appears to produce reasonable results in this particular case. (TR. 437)

Staff recommends using Consumer Advocate's adjustment for Pension Expense using a two-year average for pensions.

Other Post Employment Benefit Costs (OPEB)

IPL Initial

Initial Brief: pp. 67-68

IPL and the OCA have both taken the same relative position on OPEB costs as they have regarding pension costs. Again, IPL is relying on an averaging methodology, provided that a five-year inflation-adjusted average is employed rather than a two-year average; in order to more appropriately levelize any fluctuations. (Tr. 439-441)

Consumer Advocate Initial

Initial Brief: pp. 35-39

Mr. Hampsher adjusts OPEB costs using the same methodology used for pensions. The original amount of the adjustment for OPEB costs was $2,361,924 (Tr. 348-49). Consumer Advocate recommends using an average of 2008 and 2009 resulting in an increase of $1,181,068 to test year OPEB expense. (Tr. 1177)

Mr. Condon also proposed a corresponding adjustment to the IPL rate base for the thirteen-month average of OPEB related funds to be deposited in a Board approved external trust fund or funds as required by Board rule 199 IAC 16.9(1). These early collections represent customer contributed capital and are an offset to IPL's rate base. (Tr. 1177-79) IPL witness Hampsher agreed to this adjustment. (Tr. 433)

Mr. Hampsher acknowledged that his five-year average included both DAEC and IPL transmission employees who no longer work for IPL. Finally, Mr. Hampsher acknowledged that he never adjusted earlier years within his five-year averages for OPEB plan related changes that occurred in later years in his five-year averages. (Tr. 503-504, 557-59)

Based upon the evidentiary record, Mr. Condon's two-year average should be adopted by the Board.

ICC Initial

Initial Brief: p. 21

ICC has no objection to the adjustments proposed by OCA on the issue of OPEB costs.

IPL Reply

Reply Brief: pp. 12-13

The OCA maintains that its two-year average for adjustments is more appropriate than IPL's five-year inflation-adjusted adjustments because IPL's five-year period

will incorrectly include DAEC employees and transmission employees no longer employed by IPL. (OCA Brief p. 39)

The point of IPL's five-year inflation-adjusted average is not to capitalize on prior employees, but to even out fluctuations that would not be appropriately smoothed over by a two-year average. (Tr. 438) While the OCA's adjustment and the IPL's adjustment do not significantly differ, IPL is concerned with the precedential value of adopting the OCA's two-year average, and the improperly levelized effect that adoption could have in the future.

Consumer Advocate Reply

Reply Brief: pp. 11-12

The use of two-year average for OPEB is more in line with what IPL has experienced in the past and will experience in the near term.

Staff Analysis

IPL's argument that five-year inflation adjusted average is a superior method to capture fluctuating costs than is a two-year average only proves that the longer period of more years will reduce the variability of the average. IPL witness Hampsher stated that the use of a two-year average appears to produce reasonable results in this particular case. (Tr. 437)

Staff agrees with Consumer Advocate that treating OPEB related funds in a manner that is fully consistent with the rate-making treatment of any expense involving customer contributed capital would appear to be the correct course to follow.

Staff recommends accepting Consumer Advocate's adjustment for averaging OPEB costs over two years.

Variable Pay Plan (VPP)

IPL Initial

Initial Brief: pp. 68-70

IPL employs its VPP plan in order to attract and retain a skilled workforce. The VPP triggers when both AEC and the employee perform at an appropriate level. (Tr. 597) Because the VPP triggers at varied amounts, and periodically not at all, IPL has included this amount as a five-year inflation-adjusted average adjustment in order to appropriately levelize the fluctuations. (Tr. 441-443)

The Consumer Advocate has objected to the VPP on the grounds that it is "speculative" and may periodically result in no payouts, that there was no payout for test year 2008, and that there is no guarantee there will be payout for 2009. (Tr. 1181-1182) However, IPL asserts that the five-year inflation-adjusted average adjustment helps to smooth over these fluctuations. This can be observed by the fact that IPL has granted VPP awards in seven of the last 10 years (1999 to 2008). (IPL Exhibit LCS-2, Schedule A) The precise dollars to be paid out under the plan will be varied, hence the five-year averaging. It is only complete disallowance of the adjustment that assumes a constant, and that constant assumed for rate case purposes is no VPP award whatsoever. (Tr. 603)

The ICC has also objected to the VPP, stating that because IPL did not record any VPP expense in the test year itself, "it is clear that in the test year the performance of the employees did not produce the cost reductions, or improved profitability, adequately to award a VPP." (Tr. 1875) The ICC then forms the conclusion that, "failure of employees to meet the targets of VPP, resulted in an increase in the revenue deficiency in this case" and stated that IPL's customers should not fund VPPs since the customers saw no benefits of those VPPs. (Tr. 1876)

Consumer Advocate Initial

Initial Brief: pp. 33-35

IPL's VPP proposal is purely speculative and not known and measurable. (Tr. 1181)

IPL witness Hampsher at hearing doubted there would be any VPP award earned in 2009. (Tr. 546-547) Mr. Hampsher at hearing stated there were no budgeted VPP awards for 2010 or beyond. (Tr. 547) Mr. Hampsher states it is simply too early in the year and too much can happen between the filing of his rebuttal on August 21, 2009, and the end of 2009. However, at hearing, Mr.

Hampsher acknowledged that the VPPs had an earnings per share (EPS) threshold which must be met before any awards can be earned for 2009. (Tr. 501) In hearing Exhibit 104, Alliant, IPL's parent, announced on August 3, 2009 that its utility EPS for 2009 had changed from a first quarter 2009 EPS estimate of $1.95 through $2.25 to $1.70 through $1.90 as of the second quarter of 2009. This is well below the EPS threshold that would trigger any VPP awards for 2009 and is the most current EPS estimate for 2009.

As to Mr. Hampsher's five-year average, if at all considered by the Board, updating the five-year average for 2009 based on Hearing Exhibit 105 should also be considered and should supersede Mr. Hampsher's outdated five-year average. (Consumer Advocate Ex. 105) This also mitigates Mr. Hampsher's dated and unrepresentative five-year average which relies on former IPL transmission employees who are no longer on IPL's payroll. (Tr. 502) However, as discussed above, no VPP payments should be recognized in this proceeding.

ICC Initial

Initial Brief: pp. 19-21

IPL incurred zero VPP costs in the test year. None of IPL's employees attained the performance objectives in 2008, and consequently none of IPL's customers gained any benefits from the cost reductions or improved profitability of IPL. It would be unreasonable to force IPL's customers to incur a cost for a benefit they did not receive.

Recent precedent supports denial of VPP costs under the facts at hand. Specifically, in Board Docket No. RPU-02-3, the Board disallowed VPP recovery even though there was a VPP payout in the test year in that case. The Board concluded that, notwithstanding the current-year awards, IPL could not provide adequate evidence to justify the VPP costs and alleviate the uncertainty of future VPP payouts. Here, not only has there not been any VPP payout in the test year, but IPL has failed to offer any evidence to support VPP payouts. Indeed, IPL's Mr. Hampsher conceded that it would be "premature to predict if there will be an incentive payout for 2009." (Exhibit MPG-27) Mr. Hampsher also admitted at the hearing that it is possible that "efficiency gains achieved in one year could be lost in a subsequent year if circumstances change and the gains are not aggressively managed by management." (Tr. 541) IPL witness Stock also confirmed that "a utility must prove its variable pay plan program has provided legitimate cost reductions and/or earnings enhancements in the test year before the variable pay plan costs can be recovered in future years." (Tr. 606) IPL has failed to provide evidence of those cost reductions and/or earnings enhancements in the test year, and accordingly it should not be allowed to recover VPP costs through the revenue requirement established in this proceeding.

IPL Reply

Reply Brief: pp. 13-14

The Consumer Advocate and the ICC continue to attack IPL's proposed VPP recovery, both claiming at the core of their arguments that the requested recovery is merely "speculative." The Consumer Advocate notes that IPL did not budget for VPP awards for 2010 and beyond, while the ICC argued that IPL's employees did not meet the performance objective, and consequently, IPL's customers "should not incur a cost for a benefit they did not receive." Both of these arguments mischaracterize the evidence in this proceeding.

First, with regard to the Consumer Advocate's arguments, IPL feels it is important to clarify that IPL does not currently and has not traditionally budgeted for VPP awards. The Consumer Advocate drew forth the fact that IPL has presented testimony dealing "with VPP plans which were applicable to 2008 test year or prior years," while no testimony "deals with 2009 or thereafter." The Consumer Advocate's statement creates the implication that, because IPL does not budget for VPP awards, it must not anticipate VPP awards. IPL's lack of VPP award budgeting is simply a reflection of its past budgeting practices, and not its anticipation for VPP payouts in future years.

Because IPL has not previously budgeted for VPP awards, Alliant has itself incurred approximately 75 percent of the target expense from 1999-2008. (Exhibit LCS-2, Schedule A) AEC currently operates on a funded plan where the pool is accrued for after financial measures have been achieved, verses an additive plan where the expenses could be anticipated at the start of the fiscal year. This means that AEC's shareholders, and not its customers who also receive a benefit from IPL's workforce, have shouldered the majority of that expense.

Consumer Advocate Reply

Reply Brief: p. 11

IPL, in its initial brief at pages 68-70, totally ignores the evidentiary record and Board precedent.

The evidentiary record is clear that there are no VPP awards associated with test year 2008 or 2009. (Tr. 501, 1181; Confidential Consumer Advocate Exhibits 103 and 104) Under identical facts, the Board has found that no VPP awards should be included in the revenue requirement. See Interstate Power and Light Co., Docket No. RPU-02-3, slip op. at 36 (IUB, Apr. 15, 2003) and Interstate Power and Light Co., Docket No. RPU-02-7, slip op. at 16 (IUB, May 15, 2003)

As to IPL witness Hampsher's five-year average, if at all considered by the Board, updating the five-year average for 2009 is necessary and should supercede Mr. Hampsher's outdated five-year average. (Confidential Consumer Advocate Ex. 105) This also mitigates Mr. Hampsher's dated and unrepresentative five-year average which relies on former IPL transmission employees who are no longer on IPL's payroll. (Tr. 502) However, as discussed above, no VPP awards should be recognized in this proceeding.

ICC Reply

Reply Brief: pp. 13-14

IPL has failed to introduce any new justifications for its VPP costs. Although ICC recognizes and applauds the efforts of IPL's employees during the Flood, the fact remains that no VPP costs were paid or incurred in the test year, and are (by IPL's own admission) speculative going forward.

As confirmed by IPL witness Stock, "a utility must prove its variable pay plan program has provided legitimate cost reductions and/or earnings enhancements in the test year before the variable pay plan costs can be recovered in future years." IPL has failed to provide evidence of those cost reductions and/or earnings enhancements in the test year. Consequently, Variable Pay Plan costs should not be included in the revenue requirement established in this proceeding.

Staff Analysis

In asking for a five-year average adjustment, IPL stated that it has made VPP awards to its employees in seven years of the 10-year period from 1999 through 2008. However, no payments were made for 2008 and based on the financial targets currently contained in the plans, it is not known when payments may resume.

In IPL's last litigated rate cases, Docket Nos. RPU-02-3 and RPU-02-7, the Board disallowed the 2001 test year VPP expenses because IPL made no incentive payout in 2002 and it was uncertain when future payments would be made.

Staff would recommend no VPP adjustment. IPL should be in a better position to discuss whether payments will be made in its 2010 filing.

Accelerated Depreciation Rate for Existing Electric Meters

IPL Initial

Initial Brief: pp. 70-75

In anticipation of installing Advanced Metering Infrastructure (AMI) in the future, IPL is proposing to accelerate the depreciable life of existing electric meters from 23 years to 10 years. While IPL is not making a specific proposal to install AMI in this case, benefits of AMI/Smart Grid are well known. Since IPL expects that entire industry will be following this path soon, it is simply good practice to adjust the depreciation schedule for existing meters now. (Tr. 241) At the hearing, IPL witness Madsen committed that IPL will install AMI/smart grid within ten years, should IPL receive its depreciation proposal, with no federal grants. IPL was informed in late October that it would not receive any stimulus grant funding.

IPL's proposal is consistent with national trends. A 2007 National Association of Regulatory Utility Commissioners (NARUC) resolution recommended "to provide depreciation lives for AMI that take into account the speed and nature of change in metering technology." Several state commission orders have been consistent with this recommendation. (Tr. 241-242)

IPL's proposal is also consistent with the Energy Independence and Security Act of 2007, Section 1307 (EISA 2007) which provides a new Public Utility Regulatory Policies Act of 1978 (PURPA) Section 111(d) standard for consideration of smart grid investments, including obsolete equipment.

While Consumer Advocate and intervenors' arguments that IPL has not taken any action to install AMI may be correct in the strictest sense, such arguments ignore the preparatory work that IPL has begun for AMI deployment in Iowa service territory. This includes work on installation of Tower Gateway Basestations. (TGBs) IPL is studying whether modifications are required at each of the TGB site. IPL is also considering a test deployment of AMI electric meters and possibly gas modules, as early as second half of 2009. The goal is to develop live data to test affected internal systems. (Tr. 242-243)

Consumer Advocate recognizes the benefits of AMI technology. (Tr. 1097) The Consumer Advocate's and intervenors' request for cost-benefit information is reasonable. IPL witness Potter provided general information about the costs and benefits of AMI/smart grid. IPL noted in its comments in Board Docket No. NOI-08-03 that the development of smart grid may take many years to implement in order to fully deliver its promises. IPL is not proposing to install and recover the costs of AMI/smart grid in this proceeding. IPL is only proposing to change the depreciation schedule as a first step towards the possible benefits AMI/smart grid may provide.

IPL perceives many regulatory challenges facing future AMI/smart grid deployment. The current Iowa ratemaking structure is not well suited for a move from one metering technology to another. Historical test year is used to determine the level of costs to be included in rates. This requires IPL to place assets in service before asking for cost recovery. This scenario means IPL assumes the risk that dollars expended would be deemed impudent after the fact. This risk alone could be enough not to pursue these investments. (Tr. 262) In spite of these challenges, IPL witness Madsen was willing to commit that IPL will move forward with AMI/smart grid investments if accelerated depreciation was approved in this docket. This commitment is not contingent upon federal stimulus grant. (Tr. 262)

Contradiction is inherent in Consumer Advocate's argument regarding this issue. Dr. Habr recommends that IPL should be using different decision making – presumably to be more anticipatory of things that could take place in future. With the depreciation proposal IPL is just doing that. IPL's proposal provides Board guidance. IPL acknowledges that these future investments will need to be justified in a future rate case.

Consumer Advocate Initial

Initial Brief: pp. 42-43

IPL witness Madsen sponsors IPL's meter depreciation proposal. Initially IPL was considering, but had not made a decision to proceed with meter replacement. (Tr. 240-243) At the hearing, witness Madsen stated IPL would implement advance metering within three years if IPL obtains federal grant and ten years if it does not, assuming accelerated depreciation is approved. (Tr. 262-263)

Consumer Advocate witness Turner testified that it is premature to allow accelerated depreciation on existing meters since AMI has not, and may never, be implemented by IPL. Until IPL demonstrates that AMI deployment is beneficial to customers and AMI is actually deployed IPL should not be allowed to increase rates to recover accelerated depreciation on meters that are not obsolete and are being used by its ratepayers. (Tr. 1106-1107)

In rebuttal testimony, IPL witnesses provide hypothetical and speculative benefits of AMI, but are unable to quantify any actual benefits to customers. (Tr. 248-54, 310-20) AS IPL witness Madsen testifies, the proposal is a first step towards the possible benefits that smart grid may provide. Such "pre-approval" by the Board is not contemplated by any Iowa law, Board rule, or Board precedent. IPL's proposed adjustment should not be allowed by the Board in this proceeding.

ICC Initial

Initial Brief: pp. 15-18

IPL proposes to increase the depreciation expense of existing meters by $3.1 million in anticipation of installing AMI sometime in the unspecified and uncertain future. This proposal is wholly speculative and should be denied. The resulting claimed increase in revenue requirement should be disallowed.

IPL bases its claim on language in the EISA 2007, which provides a new section of PURPA 1978. IPL's reliance on this language has two fatal flaws. The first flaw is that AMI is far from a "smart grid system" that the rule envisions. Smart Grid concepts generally involve more than advance metering. For example, the National Institute of Standards and Technology (NIST) report Smart Grid "refers to a modernization of the electric delivery system so it monitors, protects and automatically optimizes the operation of its interconnected elements…." This definition contemplates much more than the vague statement of IPL concerning AMI. At a minimum, IPL needs to present details of what its proposal actually is. This must encompass estimated costs, expected benefits, and functions that the equipment will perform. IPL has not done any of this. The second flaw in IPL's proposal is that IPL lacks any definitive plan to deploy AMI. Witness Madsen in his direct testimony stated that IPL has "begun to develop a plan for AMI." Even if IPL obtains approval to accelerate existing meter depreciation, it will remain merely one "consideration" in IPL's decision whether or not to deploy AMI. (Madsen rebuttal at 7:21-23) Given the uncertainty as to whether IPL will ever deploy AMI, it is premature to even discuss the possibility of advancing IPL's proposal and consequently foisting additional costs on IPL's customers. Finally, the proposal should be rejected because it fails to take into account potential AMI benefits. One purported AMI benefit is a reduction in operating expense. While IPL witness Madsen recognizes potential savings, no amount of downward adjustment to expense has been taken into consideration.

An adjustment of $1.6 million to IPL's proposed rate base is required to remedy its faulty accelerated meter depreciation proposal.

LEG Initial

Initial Brief: pp. 18-20

IPL is not proposing to install and recover the cost of AMI in this proceeding. At the present time IPL has merely "begun to develop plans for AMI deployment to electric and gas customers in its Iowa service territory." (Tr. 242)

The LEG joins Consumer Advocate and ICC in opposing IPL's meter depreciation proposal. IPL has not yet implemented AMI technology and it is too

early to include any adjustment for potential costs of AMI deployment. (Tr. 1106, 1382-1383) IPL has no definite plans for AMI deployment. (Tr. 1297, 1393)

In written testimony, the LEG, Consumer Advocate, and the ICC all pointed out that IPL had failed to identify and quantify any specific benefits to customers from AMI deployment. In rebuttal testimony, IPL acknowledged the reasonableness of requiring IPL to provide cost-benefit information in support of its proposal, and purported to provide general information about costs and benefits of AMI. This general information fails to show that AMI would be cost-beneficial to IPL's customers. (Tr. 1398-1399)

IPL provides a cursory, undocumented cost-benefit discussion of its recent requests for federal funding. (Tr. 1399) The $100 million cost estimate appears to be an infrastructure investment that does not represent the total project cost. IPL has not shown that the technology will not be out of date by the time the program is completed. IPL has provided no assurance that this is a program customers would want if they knew how much they were paying for it. (Tr. 1399) IPL has failed to develop a nexus between the activities included in the general information and its proposal.

IPL is asking for Board approval regardless of whether IPL actually proceeds with AMI deployment or the Smart Grid and with no assurances that IPL would proceed with deployment even if IPL's proposal is approved. (Tr. 1400) The Board should deny IPL's proposal that would result in an immediate and continuing increase in electric rates. (Tr. 1400)

Ag Processing Initial

Initial Brief: pp. 7-8

IPL witness Hampsher has proposed accelerated depreciation of electric meters based on the expectation that AMI is imminent. As shown on Mr. Hampsher's Schedule D-14, this would result in a reduction in rate base for the test year of $1,552,242. As reflected in his Schedule B-32, it would result in an increase in the Iowa depreciation expense of $3,104, 485, for a net increase in rates of about $2.8 million.

LEG witness Latham has pointed out that AMI meters are not certain and this depreciation expense should be rejected. AGP supports the LEG position on this issue.

Consumer Advocate Reply

Reply Brief: p. 13

IPL, in its initial brief at pages 70-75 argues for accelerated depreciation on its existing meters. IPL's argument is without merit.

Since AMI has not, and may never be implemented by IPL, it is premature to allow accelerated depreciation on existing electric meters. (Tr. 1106-07)

ICC Reply

Reply Brief: pp. 10-12

In its Initial Brief, IPL reiterates its claim for accelerated depreciation but continues to fail to provide justification. IPL details potential benefits of AMI. This is a red herring. No party claims that AMI/Smart Grid does not have the potential to be beneficial. The issue is that there is not reasonable and supported basis for allowing accelerated meter depreciation in this proceeding. IPL has repeatedly stated that it has no specific plans and has not taken any action to deploy AMI. IPL points out several barriers to deployment including regulatory and practical challenges to AMI deployment and the rejection of its federal grant application.

IPL witness Madsen committed on stand to move IPL toward AMI/Smart Grid if the accelerated depreciation is granted in this docket. IPL relies on this commitment as a basis for supporting its proposal. (IPL Initial Brief, p. 71) ICC has three concerns regarding this promise: 1) The purpose of this proceeding is not to fund intangible future projects, rather it is to determine just and reasonable rates based on reasonable revenue requirements; 2) it is improper to pressure the Board to consider factors other than determining just and reasonable rates in this proceeding; and 3) Mr. Madsen's commitment to move forward with a program that admittedly has numerous flaws without a contingency for proper analysis and testing is reckless and could result in substantial harm to customers.

As IPL states, future AMI investments will need justification in future rate cases. Once concrete AMI proposals have been prepared, analyzed, and submitted to the Board for consideration, then it may be proper to discuss proposals such as accelerated depreciation. Contrary to IPL's assertion, it is not "good practice" to make customers pay for speculative projects.

LEG Reply

Reply Brief: pp. 16-20

IPL argues in its Initial Brief that its proposal is consistent with a NARUC resolution and a decision of Public Service Commission of Wisconsin (Wisconsin Commission). What IPL has overlooked is that its proposal relates to the depreciable life of existing non-AMI meters, not depreciable life for AMI as

specified in the NARUC resolution or the asset life of AMI metering as referred to in the Wisconsin Commission decision. IPL witness Madsen, at the hearing, presumed that the 15-year asset life established by Wisconsin Commission was for new meters rather than existing ones. (Tr. 232) Mr. Madsen agreed that the asset life of new meters does not relate to the remaining life of existing non-AMI meters. Mr. Madsen went on to agree that Wisconsin Commission decision was not offered to support IPL's selection of the 10-year depreciable life of existing meters. Mr. Madsen was unable to explain how IPL's selection of 10-year life takes into account the speed of meter technology change.

IPL also argues that the meter depreciation proposal is consistent with EISA 2007. Under this standard, the remaining book value of obsolete meters are to be recovered on the basis of the remaining depreciable life of the obsolete meters. Mr. Madsen testified that IPL had not performed a depreciation study to support its proposal. (Tr. 278) Mr. Madsen admitted that IPL had not submitted any evidence from which the Board could determine the remaining depreciable life of existing meters. IPL witness Hampsher testified that IPL's 2008 and 2009 depreciation studies support the 23-year depreciable life. (Tr. 530-532) A new depreciation study is required to support the proposed change. If it is reasonable to provide cost benefit analysis, as IPL admits, it should also be reasonable to require that the information is accurate.

The implicit threat in IPL's Initial Brief and testimony that IPL will not deploy AMI if the proposal is not approved by the Board is hardly credible. If approved, IPL's accelerated depreciation will add approximately $2.8 million annually to its revenue requirement for ten years. (Tr. 302-303) It is difficult to comprehend why IPL would forgo the substantial benefits of AMI for such a relatively insignificant cost to itself.

Staff Analysis

All parties agree that AMI deployment brings benefits to utility systems. Intervenors argue that IPL has not provided any information regarding the actual AMI project and equipment deployment in its service territory. IPL also did not provided any cost-benefit information regarding the actual deployment of AMI. IPL only discusses the overall general benefits of AMI/Smart Grid.

In its rebuttal case, IPL included some cost information regarding the projects that were used in its application to obtain federal grants. Since IPL did not receive any federal grants, it is not clear whether the information regarding the grant proposal is applicable any more.

IPL is asking for adjustment to its revenue requirements for future AMI projects. In fact, IPL did not commit to deploy any AMI equipment. Even if IPL receives Board approval of its depreciation proposal, IPL stated it will consider Board decision in making a final determination to deploy AMI/Smart Grid technology. It

appears that IPL is still analyzing the possibility of AMI deployment. Consumer Advocate argued that "Until IPL demonstrates that AMI deployment is beneficial to customers and AMI is actually deployed IPL should not be allowed to increase rates to recover accelerated depreciation on meters that are not obsolete and are being used by its ratepayers."

IPL witness Hampsher's Schedule D-14 shows that IPL's proposal would result in a reduction in rate base for the test year of $1,552,242. His Schedule B-32, shows that this would result in an increase in the Iowa depreciation expense of $3,104, 485, for a net increase in rates of about $2.8 million.

If and when IPL files a concrete and detailed proposal regarding actual deployment of AMI in its service territory that also includes cost-benefit information regarding the AMI project, then it may be appropriate for the Board to consider existing meter depreciation proposals. With the AMI proposal, the Board may also require IPL to file an updated depreciation study on the remaining life of existing electric meters. The current record does not include any information on why IPL chose 10 years as the depreciable life of existing meters.

SGS 4 Cancellation Costs

IPL Initial

Initial Brief: pp. 75-88

In its order issued February 13, 2009 in Docket No. RPU-08-1, the Board accepted Ratemaking Principle No. 4 which states as follows:

> If IPL cancels construction of the proposed SGS Unit 4 for good cause, IPL's prudently incurred costs shall be amortized over a period of no more than five years no later than six months after the cancellation. The annual amortization shall be included in the calculation of IPL's revenue requirement, but the unamortized balance shall not be included in rate base in any determination of interim and final rates thereafter during the period of amortization, provided however, that the prudence of the costs and the good cause for cancellation may be disputed by any party and shall be subject to determination by the Board.

On March 13, 2009, IPL filed with the Board a notice that the project would be cancelled. IPL based this decision on several factors including, cost, the economic and financial climate, increasing environmental concerns and risks associated with the Board's approved ratemaking principles.

IPL is proposing to offset the cancellation costs by using proceeds from the sale of DAEC that are in a regulatory liability account. This proposal would remove the impacts of the cancellation costs from customer rates.

Consumer Advocate argues that since the plant was not started, no principles should be valid and believes that IPL is bound to either all or none of the principles. Consumer Advocate witness Fuhrman then argues that if the Board allows some recovery of cancellation costs, no more than 50 percent should be borne by ratepayers. Witness Fuhrman agrees with IPL that any recovery should be offset by funds in the DAEC regulatory liability account.

ICC argues that only that part of the project expected to serve IPL's retail load should be recoverable. In addition, costs assigned to IPL's partners should not be charged to IPL.

IPL would note that SGS 4 is the first plant with ratemaking principles to be cancelled. The clear intent of Principle No. 4 is to insure that utilities are not perversely incented to: 1) avoid construction of a plant for fear that good faith dollars spent will be stranded; and 2) that a utility must begin construction of a project that will never go into service. IPL believes that the Consumer Advocate's position goes against the basis purpose of Principle No. 4.

Cost of SGS 4

IPL states that discussions with its contractors indicated that SGS 4 would not be able to be built for the allowed cost cap. This put additional risk on stockholders for costs over the cost cap.

Investment Community Response

The investment community looked at the Board's allowed ratemaking principles as being a detriment to the construction of SGS 4.

Uncertain Environmental Regulation and Board Conditions

Added uncertainty regarding environmental legislation relating to carbon emissions added to the uncertainty of constructing SGS 4. In addition, the Board's conditions relating to renewable and biomass added to the overall costs and uncertainty of SGS 4.

Ratemaking Principle Decision

IPL believes that the Board's decision on ratemaking principles in Docket No. RPU-08-1 added to the overall risk of constructing SGS 4, including:

1. Cost risk of exceeding the cost cap;

2. Uncertainty regarding the ROE that would be applied to costs above the cost cap;
3. Cost disallowances for any unassigned generating capacity over IPL's 350 MW share;
4. Uncertainty regarding the renewable standards, including the additional risks associated with meeting the Board's conditions; and
5. An ROE of 10.1 percent that was deemed too low to attract capital.

Consumer Advocate was opposed to the construction of SGS 4 beginning with Docket No. GCU-07-1 and continuing with Docket No. RPU-08-1. However, Consumer Advocate is questioning whether IPL has shown good cause for cancelling the project. IPL believes that logic would indicate that if Consumer Advocate opposed the project from the beginning, avoiding the rate impacts of construction would be deemed by Consumer Advocate as "good cause" for cancellation.

Consumer Advocate 50/50 Proposal

Consumer Advocate argues that if the Board allows recovery of the SGS 4 cancellation costs, the costs should be split between ratepayers and stockholders. This proposal was not included by Consumer Advocate in its proposal in Docket No. RPU-08-1. If it had been proposed at that time, the parties would have had a better opportunity to discuss the merits.

Partner Costs

IPL has agreed to exclude costs assigned to its partners. However, at this time it is not clear as to if IPL will be responsible for any of these costs. IPL will not include these costs in this case but will bring the matter before the Board in a future docket if conditions change.

Conclusions

The intent of Ratemaking Principle No. 4 is to reduce the risk to IPL if conditions change in a way that makes construction of SGS 4 too risky. The costs that were incurred prior to cancellation were prudently incurred and should be allowed to be recovered. Disallowing these costs or only allowing a portion would completely change what Principle No. 4 intended and would make future ratemaking principle decisions questionable. IPL has removed both land costs and costs assigned to IPL's partners from its request as suggested by Consumer Advocate.

Disallowing the recovery of prudently incurred costs would add additional risk to any future generation proposals. The SGS 4 costs were prudently incurred and should be allowed for recovery.

Consumer Advocate Initial

Initial Brief: pp. 27-30

IPL initially requested recovery of $42.6 million in costs related to SGS 4. Consumer Advocate discovered costs relating to land purchases and costs assigned to IPL partners included in this proposal. IPL removed these costs on rebuttal, leaving only the question of if these remaining costs should be recovered. Since IPL never began construction of SGS 4, the principles approved by the Board are not applicable.

IPL cancelled SGS 4 largely due to its dissatisfaction with the terms and conditions approved by the Board in Docket No. RPU-08-1. The evidence in this case does not show that IPL cancelled the project due to new load requirements showing the plant was no longer needed, or that costs had increased to a point that the plant was no longer justified.

IPL's unwillingness to accept the terms provided by the Board does not constitute good cause for cancellation. IPL should not be permitted to pick and choose which principles to accept. (Tr. 890-891)

As an alternative to complete disallowance, Consumer Advocate recommends that if the Board believes that recovery is appropriate, only 50 percent of the costs should be charged to ratepayers. The remaining 50 percent should be borne by IPL shareholders. Consumer Advocate agrees that the DAEC proceeds should be used to offset any recovery of SGS 4 cancellation costs.

ICC Initial

Initial Brief: pp. 18-19

IPL should not be allowed to request recovery of any costs assigned to its partners. It is not reasonable to ask IPL customers to pay for the costs associated with its partner's share of cancellation costs.

IPL Reply

Reply Brief: pp. 14-15

IPL has responded to the arguments offered by Consumer Advocate and has eliminated partner costs and land costs. However, IPL does not agree with the proposed 50/50 sharing proposed by Consumer Advocate. In fact, as agreed to by witness Fuhrman, the parameters set by Principle No. 4 do provide for sharing of costs between customers and shareholders. (Tr. 942) By not allowing for the recovery of carrying costs through the rate base, shareholders are covering some of the costs of the SGS 4 cancellation.

Consumer Advocate Reply

Reply Brief: pp. 8-10

IPL believes that it should be allowed recovery of its SGS 4 cancellation costs, even though it never accepted the principles offered by the Board in Docket No. RPU-08-1, and cancellation took place prior to beginning construction.

Principle No. 4 specifically states that it applies "if IPL cancels **construction** of the proposed SGS Unit 4 for good cause…" (Tr. 30) Since IPL never began construction Principle No. 4 does not apply.

IPL indicated on brief that the Board's principles in Docket No. RPU-08-1 resulted in negative fallout from Wall Street. Clearly, IPL did not like or accept the principles as offered by the Board. At most, customers and shareholders should share the cost of the SGS 4 cancellation.

ICC Reply

Reply Brief: p. 13

ICC maintains that customers should not pay for any costs assigned to IPL's partners in the SGS 4 project. In addition, IPL should not be allowed to seek recovery of any partner costs in a future proceeding.

Staff Analysis

In the Board's Order in Docket No. RPU-08-1, the Board approved Principle No. 4 which states:

> If IPL cancels construction of the proposed SGS Unit 4 for good cause, IPL's prudently incurred costs shall be amortized over a period of no more than five years no later than six months after the cancellation. The annual amortization shall be included in the calculation of IPL's revenue requirement, but the unamortized balance shall not be included in rate base in any determination of interim and final rates thereafter during the period of amortization, provided however, that the prudence of the costs and the good cause for cancellation may be disputed by any party and shall be subject to determination by the Board.

IPL's basic position is that the cancellation costs were prudently incurred. A change in the perception of coal-fired generation, the economic downturn, the requirements set by the Board in Docket No. GCU-07-1, and the principles allowed by the Board in Docket No. RPU-08-1 all led to the decision to cancel the

project. IPL believes that Principle No. 4 allows for the recovery of prudently incurred costs and that the cancellation is due to factors that were out of the control of IPL management prior to the time construction was scheduled to begin.

Consumer Advocate is arguing that since the plant was cancelled prior to construction, all principles are moot. IPL is correct in stating that SGS 4 is the first project that received advanced ratemaking principle treatment to be cancelled. What is unclear is the actual intent of the wording of Principle No. 4.

In part, Principle No. 4 states: "the prudence of the costs and the good cause for cancellation may be disputed". Consumer Advocate does not appear to be questioning the cancellation cost level now that IPL has agreed to exclude the costs for land acquisition and partner costs. In addition, Consumer Advocate did not respond to IPL's notices that the SGS 4 project would be terminated. It does not appear that Consumer Advocate, at any time, questioned the rationale for canceling the project.

Consumer Advocate argues that if the Board allows cost recovery of the SGS 4 cancellation costs, the costs should be shared equally between IPL ratepayers and IPL shareholders. Staff does not believe the intent of Principle No. 4 calls for a complete 50/50 sharing. Staff would note that since Principle No. 4 states that no rate base treatment will be allowed over the five years, in effect, shareholders are covering the carrying costs related to the delayed recovery as pointed out by IPL.

Both parties have agreed that the balances in the DAEC regulatory liability account should be used to offset any cancellation costs allowed by the Board in this proceeding.

Staff Conclusion

IPL is correct in stating that SGS 4 is the first project receiving ratemaking principle treatment by the Board to be cancelled. Consumer Advocate argues that since construction did not begin, all principles become moot. However, staff believes that based on Consumer Advocate's argument, no cancellation principle would ever be valid unless construction had already begun. This would only lead to a higher level of cancellation costs.

It may be true that a main reason for cancellation was due to IPL not receiving what it wanted in Docket No. RPU-08-1. However, based on the fact that Consumer Advocate opposed the plant from the beginning; and that Consumer Advocate did not comment on the cancellation notice, Consumer Advocate agrees with the cancellation of SGS 4.

Staff believes that it is not reasonable to base the validity of the cancellation principle on the commencement of construction. Also, it is not reasonable to

include the cancellation principle with the other four principles, all of which only become effective if the plant is built and put online.

Consumer Advocate argued for the exclusion of both partner costs and land costs, both of which have now been removed by IPL. In addition, neither Consumer Advocate nor ICC identified specific costs that were not prudently incurred. Since there is nothing in the record that would indicate that any of the remaining costs proposed to be recovered by IPL are imprudent, staff believes that recovery should be allowed. Allowing IPL to use the proceeds from the DAEC regulatory liability account would negate any increases to the revenue requirement as a result of allowing recovery of the SGS 4 cancellation costs.

In addition, ICC argues that IPL should not be allowed to seek recovery of any future or new partner costs in any future proceeding. However, staff believes that since recovery of any additional costs would be subject to Board review, IPL should be allowed to make the proposal, subject to the Board's authority to determine prudence for recovery.

Interest Synchronization

Consumer Advocate Initial

Initial Brief: pp. 43-45

The interest synchronization adjustment is an adjustment to federal and state income taxes to match the tax deductible interest included in the revenue requirement. The method of calculating the adjustment is not in dispute. The final interest synchronization adjustment should reflect the debt interest expense included in the revenue requirement as a portion of the over-all return on rate base.

Consumer Advocate proposes that the Board account for Alliant's use of double-leverage in its financing of IPL's rate base and – consistent with Board precedent – inclusion of that portion of Alliant's interest expense included in the over-all return on rate base in the interest synchronization adjustment.

Consumer Advocate's proposed accounting for Alliant's use of double leverage in the capital financing of IPL's rate base is addressed elsewhere in Consumer Advocate's brief. If, as Consumer Advocate urges, double leverage is properly accounted for in the determination of the rate of return on rate base, then the deductibility of all of the interest expense included in the revenue requirement should be accounted for properly. It would make no sense to treat revenue to recover AEC debt interest expense in the revenue requirement as taxable income rather than the recovery of tax deductible interest expense. Such a result would deny accounting for the actual tax deductibility of interest expense permitted by federal and state corporate income tax law.

ICC Initial

Initial Brief: p. 18

ICC has no objection to the adjustments proposed by Consumer Advocate on the issue of interest synchronization.

ICC Reply

Reply Brief: p. 12

ICC maintains its original position with respect to interest synchronization.

Staff Analysis

The method of calculating the adjustment is not in dispute. The differences are based on the proposed weighted cost of debt and the size of the rate base. When the weighted cost of debt and the size of the rate base are determined, the adjustment for interest synchronization will be determined.

Workforce Reduction

IPL Initial

Initial Brief: pp. 65-67

In May 2009, IPL's parent company, AEC, instituted a workforce reduction in order to deal with first quarter sales reductions and create greater efficiencies within the Company. Given continuing economic factors, IPL assumed this workforce reduction would be more long-term and incorporated the effects of this reduction into its rebuttal testimony as an ongoing adjustment. (Tr. 435)

IPL believes the Consumer Advocate has extended certain other adjustments beyond what is reasonable in light of these workforce reductions. In particular, the Consumer Advocate has excluded the severance costs necessary to achieve these reductions. IPL had recommended these severance costs be amortized and recovered over a four-year period. (Tr. 436, Exhibit CAH-2, Schedule B-39) The Consumer Advocate's adjustment, however, would flow the benefits to IPL's customers of the overall salary and benefits reductions without allowing IPL to recover any of the costs associated with achieving those benefits.

Consumer Advocate alleges that the severance costs were offset by "other limited time cost savings the company has exercised in 2009…" (Tr. 1132) These cost savings measures are the temporary suspension of AEC's 401(k)

matching program (discussed in Salaries and Wages), the company-wide one week furlough for non-bargaining unit employees and participating bargaining unit employees, and contributions to AEC's deferred compensation plan (which is already included in the 401(k) matching program amounts). (Tr. 1133-1134, 1135-1136) The Consumer Advocate's witness acknowledged that these three temporary cost savings measures were accomplished with the understanding that they would not continue indefinitely. (Tr. 1136) Using temporary cost savings measures to offset the costs of a measure that creates long-term benefits is illogical, and ultimately punishes IPL for taking prudent long- and short-term cost-cutting actions for its customers' benefit.

Consumer Advocate witness estimated the 401(k) match at approximately $2.2 million, which is about half of the $4.46 million total 401(k) match. (Tr. 1133, 1139) However, this amount did not take into account any of the appropriate allocations to reflect an Iowa electric allocable amount. (Tr. 1140-1141) Applying the appropriate allocation percentages and *then* halving the amount produces a result of approximately $1.1 million of total discontinued 401(k) matching funds. (Tr. 1143-1144) The total effect of the one-week furloughs, after appropriate Iowa electric allocations, is approximately $1.3 million. (Tr. 1144) Because the deferred compensation plan amounts are included in the 401(k) matching fund amounts, the total amount the Consumer Advocate proposes to use to offset the severance costs is actually only approximately $2.4 million. (Tr. 1144-1145) This is nearly $1 million short of offsetting IPL's severance costs. Even if IPL agreed that the costs of a long-term benefit could be offset by short-term cost savings, the offset proposed by the Consumer Advocate would be insufficient.

Consumer Advocate Initial

Initial Brief: p. 32.

In rebuttal, IPL witness Hampsher recognized that IPL should make the workforce reduction adjustment proposed by Mr. Kebede, with one caveat. Mr. Hampsher proposed recovery of severance costs of approximately $3.3 million amortized over four years, or $0.8 million to be reflected in this proceeding. (Tr. 434-36)

In rebuttal, Mr. Kebede disagreed with IPL recovering severance costs. Mr. Kebede testified that IPL's suspension of its 401(k) contribution in 2009 and IPL's one week mandatory furloughs from employees in 2009 would offset the one-time nonrecurring severance costs. (Tr. 1132-34) At hearing, these offsets were quantified at approximately $2.4 million. Consequently, the only portion of Mr. Hampsher's claimed $3.3 million is $900,000 to be amortized over 4 years. (Tr. 1144)

ICC Initial

Initial Brief: p.15

ICC has no objection to the adjustments proposed by Consumer Advocate on the issue of workforce reduction.

IPL Reply

Reply Brief: pp. 11-12

The Consumer Advocate continues to extend certain temporary adjustments beyond what is reasonable in light of these more permanent workforce reductions by excluding the severance costs necessary to achieve these reductions, and arguing these can simply be "offset" by other short-term adjustments. (Consumer Advocate brief, p. 32)

Consumer Advocate Reply

Reply Brief: pp. 10-11

A $2.4 million offset must be made to IPL's claimed $3.3 million of one-time nonrecurring severance costs. The $900,000 difference should be amortized over four years.

ICC Reply

Reply Brief: p. 10.

ICC maintains its original position with respect to workforce reduction.

Staff Analysis

IPL believes it should be allowed an adjustment for severance related costs attributable to Iowa electric operations of $3,345,548 pertaining to the workforce reduction. IPL recommends this amount be amortized and recovered over a four-year period. IPL continues to maintain that allowing the Consumer Advocate's adjustment would flow the benefits to IPL's customers without allowing IPL to recover any of the costs associated with achieving those benefits. IPL reiterates that using temporary cost savings measures to offset the costs of a measure that creates long-term benefits is illogical, and ultimately punishes IPL for taking prudent long- and short-term cost-cutting actions for its customers' benefit.

Consumer Advocate contends that IPL should not be allowed to amortize and recover the one-time severance pay of $3.3 million. Consumer Advocate states that the savings from the suspension of its 401(k) contribution in 2009 and IPL's one week mandatory furloughs from employees in 2009 would offset the one-time nonrecurring severance costs. At hearing, the offsets were quantified at $2.4 million, therefore, the most that should be amortized is the resulting difference of $900,000 to be recovered over four years.

Staff would recommend that the Board accept Consumer Advocate's workforce reduction adjustment of $900,000 to be amortized over 4 years.

Management Efficiency

IPL Initial

Initial Brief: pp. 6-31

Consumer Advocate and ICC argue that IPL should be penalized for poor management decisions. Consumer Advocate argues for a $50 million reduction to the revenue requirement, or the equivalent of 380 basis points. ICC argues for a reduction to the ROE of 30 basis points, roughly a $3.7 million reduction to the revenue requirement. The Board's rules state that any awards or penalties should be based on adjustments to the ROE. Consumer Advocate's proposal does not do this.

Consumer Advocate bases its recommendation on MEC having lower rates, Alliant Energy Corporation's (Alliant) unregulated activities, and the sales of DAEC and the IPL transmission system. In addition Consumer Advocate witness Habr argues that IPL should have been more aggressive in building generation, namely wind. (Tr. 1022)

ICC bases its recommendation on IPL's increased costs related to the sale of the IPL transmission system. (Tr. 1818)

IOWA CODE §476.52 identifies three areas of analysis to be used in determining if a penalty or award should be granted, including:

1. The utility is operating in an inefficient manner;
2. The utility is not exercising ordinary, prudent management;
3. In comparison to other utilities in the state, the utility is performing in a less beneficial manner.

In addition, Iowa Admin. Code 199-29 states in part:

> The reality of change, and the ability of management to anticipate and respond to these changes, greatly affect any judgment of management efficiency, and must be considered in establishing any rewards for efficiency or penalties for inefficiency.

IPL vs. MEC Rate Comparison

While it is true that IPL's rates are on average higher than MEC at the current time, this does not indicate that IPL is operating in an inefficient manner. Consumer Advocate admits that MEC is in a position that is rare and may not be similar to any other utilities. (Tr. 1062) Rather, IPL's rate levels are consistent with those of other utilities in the region. MEC's capacity availability is based on decisions that were made decades ago. Consumer Advocate witness Habr is attempting to penalize IPL for decisions made many years ago.

The main differences between IPL and MEC relate to:

- Decisions on generation units;
- Retail rates prior to 2000;
- Variable cost differences due to the size, location and age of generation (Tr. 581-591); and
- The ability to offset cost increases through wholesale sales.

Consumer Advocate witness Habr argues that IPL should have been more aggressive in adding generation. However, he fails to include in his reasoning the substantial capital costs and associated rate increases necessary to pay for these new generating assets.

In Docket No. RPU-91-8, IPL predecessor company Iowa Southern Utilities Company requested a management efficiency award based on its ability to keep costs low. Consumer Advocate argued that the lack of spending could in the long run lead to less reliable service along with safety issues. Consumer Advocate appears to argue both sides of the issue. In one case, it criticizes the utility for spending too much and the other for not spending enough.

Alliant Unregulated Activities

Consumer Advocate argues that IPL invested in unregulated activities that have impacted IPL's rates. However, since IPL has stated on the record that all foreign investments were sold by 2007, there can be no costs related to foreign investments in the 2008 test year.

Duane Arnold Energy Center Sale

IPL sold the Duane Arnold Energy Center in January 2006. This sale was fully litigated and approved by the Board. The sale of DAEC was not based solely on

declining earnings. Consumer Advocate witness Habr fails to identify the fact that IPL believed the sale would reduce operating risk, decommissioning risk, spent fuel risk NRC risk and relicensing risk. IPL was a small utility that owned one nuclear asset. By selling DAEC while retaining the access to the capacity from the plant, IPL was able to reduce risk while at the same time retain the benefits without increasing costs. (Tr. 60-61)

Consumer Advocate witness Habr also believes that IPL is paying for decommissioning funding that is not needed. However, the NRC has clearly stated that the DAEC decommission fund has not met minimum funding levels. The DAEC PPA was designed to mirror the costs that IPL would incur if it were to retain DAEC through the end of the license in 2013.

Transmission Sale to ITC Midwest

In December 2007, IPL finalized the sale of its transmission system to ITC Midwest. Consumer Advocate witness Habr argues that the sale was driven by the motivation to insure that short term earnings targets were met. (Tr. 1017)

IPL began discussion as far back as 1998 about forming a transmission-only company. IPL filed with the Board in 2002 to transfer its transmission assets to TRANSLink, a proposed independent transmission company. This request was disapproved by the Board in June 2003. IPL reached an agreement with ITC Midwest in 2007 to sell all transmission assets. The Energy Policy Act of 2005 (EPAct 2005) provided incentives to build transmission. In addition, EPAct 2005 provided incentives to encourage the divestiture of transmission assets to independent transmission companies. ITC Midwest is an independent transmission company that has the means to invest in need infrastructure which will promote the advancement of Iowa's renewable energy and alternative fuels industries.

Use of Proceeds from DAEC and IPL Transmission Assets

Consumer Advocate witness Habr argues that the proceeds from these sales were used for unregulated purchases along with share repurchases. (Tr. 1018-1019) He also argues that the sales boosted EPS and the incentive compensation that is tied to it. Consumer Advocate witness Habr fails to note that all net proceeds from the DAEC sale were put into a regulatory liability account and did not affect EPS. In addition, while the sale of the transmission system did increase EPS, the proceeds were not included in calculations for 2008 incentive compensation calculations. (Tr. 69)

IPL Awards

Consumer Advocate witness Habr goes to great lengths to be critical of IPL management. However, he fails to credit IPL for the positive recognition that has

been received for responding to the 2008 floods, energy efficiency, and many other areas. (Tr. 71)

Response to ICC

IPL is being proactive in keeping ITC Midwest costs down. IPL was able to achieve a $10 million reduction in costs for 2009. IPL has also filed a complaint with FERC and will continue to challenge ITC Midwest on cost issues.

Conclusions

Consumer Advocate witness Habr has failed to identify any of the $50 million proposed reduction as being based on imprudent or inefficient expenses that IPL can eliminate from its 2008 cost of service. Consumer Advocate witness Habr focuses on the past but provides little as to what should be done by IPL to fix the perceived problem. Consumer Advocate witness Habr proposes to punish IPL for past wrongs that can no longer be rectified while at the same time not being able to offer any meaningful actions that IPL can take that would not add further increases to rates due to the large capital outlays necessary for additional generation. (Tr. 74)

Consumer Advocate witness Habr fails to realize that any generation additions will involve significant capital additions and the subsequent cost increases that go with added rate base. Consumer Advocate is not attempting to incent IPL to change its practices but is merely proposing a penalty based on decisions made many years ago.

IPL has gone five years without a rate case while at the same time working through two ice storms and a major flood. This is hardly a cause for a management penalty.

<u>Consumer Advocate Initial</u>

Initial Brief: pp. 13-27

Consumer Advocate recommends that IPL be penalized $50 million to reflect the fact that IPL is performing at a level that is less beneficial than other Iowa utilities and to provide an incentive for IPL to improve its inefficiencies.

MEC vs. IPL Price Comparison

During 2008, IPL customers paid over $248 million more than MEC customers for the same service. Over the past five years, this difference exceeds $1 billion. (Tr. 1002) Over this time period, IPL saw average usage for large customers go down by 14 percent while MEC realized increases of 12 percent over the same time period for large customers. In addition, the number of large customers at

IPL grew by 9.1 percent compared to 21.6 percent for MEC. During this same timeframe, MEC added 2,255 MW of capacity with a total cost of over $3 billion, without raising prices. During this period IPL added the Emery Generating Station at a cost of $402 million while liquidating both DAEC and the IPL transmission system.

Unregulated Activities

While MEC focused on its core utility operations, IPL focused on its unregulated business diverting managements focus from IPL. Alliant's 2000 strategic plan was focused on large earnings from its unregulated businesses. By 2004, Alliant had invested over $700 million in foreign markets. Combined with the collapse of the McLeod USA stock value in 2001, Alliant made the decision to reduce its dividend. Consumer Advocate believes that the non-regulated activities by Alliant reduced the focus put on IPL by upper management.

DAEC Sale

The sale of DAEC allowed IPL the opportunity to repurchase shares and also the ability to "trade in" depreciated assets earning low returns for new assets receiving inflated returns resulting from HF 577. (Tr. 1010-1013) By repurchasing shares, IPL's EPS would increase, potentially leading to higher incentive compensation payments.

As a result of the DAEC sale, IPL customers are paying approximately $13 million/year for decommissioning costs that NextEra is not paying. Relicensing the plant would have given these benefits to IPL customers.

The DAEC PPA was structured to mirror the costs of IPL retaining ownership until decommissioning in 2014 resulting in a higher rate than may have been negotiated.

The sale of DAEC removed the protection of the clean generation that DAEC provides. This generation will only become more valuable once carbon legislation is enacted. (Tr. 1014-1015)

ITC Midwest Transmission Sale

The sale of the IPL transmission system included an Alternative Transaction Adjustment (ATA) designed to offset cost increases for eight years. The evidence is clear that the added costs resulting from the sale to ITC Midwest far exceed the offset coming from the ATA.

Wind Development

IPL has failed to be proactive in developing wind generation. MEC began installing wind in 2004 at a cost of $1,143/MW and now has an overall average of $1,721/MW. This compares to the Whispering Willows project that IPL is finalizing at a cost of $2,125/MW, significantly higher than if it had built the plant earlier.

If IPL had installed wind generation at the same time as MEC, $94 million in purchased power costs could have been avoided. (Tr. 1021)

Fuel Cost Variances

MEC has significantly lower fuel costs than IPL. Part of this discrepancy is due to the low fuel costs at MEC's Quad City Nuclear Station. In addition, MEC has a much greater incentive to keep fuel costs low, since it does not have an Energy Adjustment Clause. (EAC)

IPL witness Blankman failed to outline the efforts that IPL has taken to reduce its fuel costs. IPL appears content to simply pass the costs of fuel to customers via the EAC.

Conclusion

Consumer Advocate witness Habr is proposing a reduction of $50 million from IPL's revenue requirement. This is only 20 percent of the roughly $248 million in costs that IPL customers pay compared to MEC customers receiving the same service. The proposed adjustment is necessary to send a loud signal to senior management that the focus needs to be on IPL.

ICC Initial

Initial Brief: pp. 68-69

IPL's transmission expenses have increased substantially due in large part to the inefficiencies of IPL management. ICC proposes a 30 basis point reduction to the allowed ROE ($3.7 million reduction to revenue requirement) to account for IPL's failure to manage transmission expenses. This reduction should be enough to get IPL's attention while at the same time without materially undermining IPL's ability to attract capital.

IPL Reply

Reply Brief: pp. 1-5

IPL believes that Consumer Advocate witness Habr's proposed management efficiency penalty is without merit.

Consumer Advocate continues to argue about issues relating to:

IPL vs. MEC rates
Unregulated activities
Sales of DAEC and IPL transmission assets
DAEC PPA
Wind Investments
Fuel Costs

Witness Habr does not take any issue with the processes and tools used by IPL to manage its corporate and strategic plans. In addition, witness Habr does not address energy efficiency, a component listed in 199 IAC 29, the Board's management efficiency rules.

Consumer Advocate Reply

Reply Brief: pp. 5-8

IPL believes that it is operating in an efficient manner. However, as clearly stated at the consumer comment hearings, IPL customers disagree. (Tr. 27-28) IPL's attempt to explain differences in rates only reinforces Consumer Advocate witness Habr's findings that IPL rates are largely the result of poor management decisions over several years. IPL argues that it has no capacity to sell on the wholesale market. IPL can only blame itself for being in this situation. In addition, the sale of DAEC has left IPL in a position of having to rely heavily on purchased power, rather than lower cost, self generation.

ICC Reply

Initial Brief: pp. 26-28

IPL argues that a management efficiency penalty is not warranted because: 1) IPL is not operating in an inefficient manner; 2) Ordinary, prudent management is being exercised; 3) IPL is not operating in a manner less that other utilities.

ICC believes that a penalty is warranted simply by the mismanagement by IPL of its transmission expenses. ICC recommends a reduction of 30 basis points to the IPL ROE, resulting in a decrease to the revenue requirement of $3.7 million. IPL has admitted that its transmission costs are too high, and has filed a complaint with FERC to investigate this matter. (IPL Initial, pp. 25-26) IPL witness Aller admitted that IPL never considered that selling to ITC Midwest could lead to the doubling of transmission rates. (Tr. 136-137)

IPL argues that all the arguments presented by Consumer Advocate are based on events that occurred in the past and cannot influence future decisions. However, all facts used to determine management efficiency are based on

historical performance. Based on IPL's argument no past decisions should be included in determining if a penalty is warranted. This concept makes no sense and should be ignored.

Staff Analysis

IOWA CODE § 476.52 states in part:

> …If the board determines in the course of a proceeding conducted under section 476.3 or 476.6 that a utility is operating in an inefficient manner, or is not exercising ordinary, prudent management, or in comparison with other utilities in the state the board determines that the utility is performing in a less beneficial manner than other utilities, the board may reduce the level of profit or adjust the revenue requirement for the utility to the extent the board believes appropriate to provide incentives to the utility to correct its inefficient operations…

The above statute lays out three basic questions that must be used when determining the efficiency of the utility's management, including:

1. Is the utility being operated in an efficient manner?
2. Is management operating the utility in a prudent manner?
3. Is the utility being operated in a way that is reasonable compared to other utilities in the state?

The proposed management inefficiency penalty proposed by Consumer Advocate is based on the following areas of critique, including:

1. IPL vs. MEC Rate Comparison
2. Fuel Cost Variances
3. DAEC Sale – Docket No. SPU-05-15
4. ITC Midwest Sale – Docket No. SPU-07-11
5. Holding Company Investments (Unregulated Activities)
6. Use of DAEC and ITC Midwest Sale Proceeds

1. IPL vs. MEC Rate Comparison

Consumer Advocate's position is that if IPL had made the same decisions as MEC over the past eight years, its rates would be substantially lower. For 2008, Consumer Advocate states that IPL customers paid approximately $248 million more than they would have using MEC rates.

Consumer Advocate notes that over this time, MEC added 2,255 MW of capacity with no rate increases, while IPL added only 552 MW with several rate increases.

Consumer Advocate is arguing that while MEC took significant advantage of HF 577, IPL for the most part ignored it.

IPL believes that it is difficult to compare IPL to just MEC. IPL argues that they are performing at levels very comparable to other utilities within the region, while MEC is in a unique situation that has allowed them to freeze rates for several years.

MEC has been able to keep rates constant due mainly to the margins received from wholesale sales. While MEC has been a large net seller for several years, IPL has been dependent on the wholesale market to meet its native load requirements. IPL has consistently been required to purchase a portion of its energy needs. As the market has tightened and prices have gone up, IPL has been forced to pay higher prices. In addition, since IPL does not sell a significant amount, there are few wholesale revenues to offset retail cost increases.

In addition to the build/purchase philosophies of each utility, it is important to note that MEC's generating fleet, on average, is newer and more efficient than IPL's.

IPL has now put itself into a position where there will be a greater need for baseload generation and no good answer in how to get it. The major types of baseload capacity, namely coal and nuclear, will be very difficult for IPL to acquire. IPL will likely be forced to continue meeting its native load by purchasing power. In addition, if IPL is unable to extend its PPA with NextEra for the capacity at DAEC, IPL would then be even more susceptible to purchased power costs. While IPL is in the process of installing wind capacity, which will help meet IPL's energy requirements, wind will not replace the baseload capacity provided by the DAEC contract.

Staff Conclusion

Staff believes that although it is true that MEC has lower rates than IPL, it is not reasonable to base a penalty on this fact. MEC is benefitting from having excess capacity that has provided significant levels of income for several years. Absent this added source of income, MEC would very likely have rates that are significantly higher than they currently are. In order to make a fair comparison, it would be necessary to calculate MEC's rates based on its retail costs. This would then provide a more accurate comparison between IPL and MEC's rates. However, this comparison is not part of the record.

2. Fuel Cost Variances

Consumer Advocate argues that MEC's fuel costs are significantly lower than IPL's and claims that poor management decisions by IPL have led to this disparity.

It is true that MEC has lower fuel costs than IPL. However, there are several reasons for this, some of which are out of the control of IPL's current management. The main reasons for the price disparity are:

- MEC plants are on average newer and more efficient
- MEC contracts are currently more favorable than IPL's
- MEC plants are geographically located in areas closer to the coal fields

Staff believes that the above reasons are valid differences and significantly affect fuel prices between IPL and MEC. While it is true that MEC's generating fleet is on average newer, IPL management has not been aggressive in looking to add or replace the current fleet. MEC added the Walter Scott Energy Center in 2007. This plant accounts for generation equal to 87 percent of IPL's coal generation energy output in 2008. (Tr. 584-585)

Staff would note that although IPL did not discuss the issue, it should be noted that while IPL has an EAC, MEC does not. As part of the original Alternative Pricing Proposal, Docket No. APP-96-1, MEC proposed to roll in a representative fuel amount into base rates and then eliminate its EAC. An EAC is a direct pass through of fuel costs that nearly guarantees IPL recovery of its fuel costs. Since MEC does not have an EAC, fuel costs above the embedded amount in base rates are not recovered. MEC also has the opportunity to profit from this if it can keep fuel costs below the embedded levels. It is very clear that MEC has a much greater incentive to keep fuel costs as low as possible. IPL's current EAC levels are significantly above what they were at the time MEC eliminated its EAC. The main driver for this increase is likely due to increases in purchased power costs.

Staff Conclusion

Currently, IPL has fuel costs that are significantly higher than MEC. IPL argues that the reasons for this are due to reasons that are out of IPL management control. While it is true that IPL management cannot change decisions from many years ago, recent management decisions will likely affect future fuel costs, mainly, the sale of DAEC and the cancellation of SGS 4. These decisions have put IPL in a position of being reliant of the wholesale market for a large portion of its capacity needs. IPL's average EAC has increased significantly over the past several years. The majority of this increase can be tied to purchased power costs increases. Staff does not see any clear solution to this problem. IPL indicated that they may propose a gas-fired baseload plant. However, using gas to fuel a baseload plant adds to the risk of significant cost increases due to the volatility of natural gas costs.

IPL management should have been more aware of its fuel mix in past years and could have avoided being so dependent on the wholesale market, however it would be difficult to penalize IPL based on this.

3. DAEC Sale – Docket No. SPU-05-15

Consumer Advocate witness Habr argues that the sale of the DAEC has caused prices to increase and will result in additional pressure on prices in the future. Consumer Advocate's argument is based on the results of sale to NextEra. Witness Habr is correct in stating that IPL is paying $13 million/annually for decommissioning costs that NextEra is not currently putting into decommissioning funds. However, the obligation to pay has now shifted to NextEra. NextEra agreed to pay for the decommissioning of DAEC, regardless of the cost. IPL no longer has the risk associated with decommissioning a nuclear plant. The DAEC PPA includes a similar amount to what was included in IPL's rates to account for future decommissioning costs while IPL owned the plant. The current DAEC PPA was designed to parallel the costs IPL would have incurred if ownership was continued and the plant was decommissioned in 2013. IPL ratepayers have not seen an increase in rates due to the sale of DAEC.

Based on the information in the record of Docket No. SPU-05-15, there is no basis to indicate that decommissioning costs would have gone down. Relicensing, if approved, would have given IPL a longer timeframe to collect the dollars necessary to decommission the plant. While this is true, there are many variables that, over the life of the relicensed plant, could significantly increase the cost of decommissioning. IPL indicated at hearing that the NRC has concluded that the DAEC decommissioning fund is not adequately funded. NextEra will clearly need to begin adding funds to this account to meet NRC funding levels.

Staff would note that IPL's estimated decommissioning costs increased in nearly every rate case beginning in the 1980's. Several adjustments were made to increase the amount collected for decommissioning throughout IPL and its predecessors ownership of DAEC. NextEra has chosen to not add to the DAEC decommissioning fund. If the costs of decommissioning rise as has been the case for many years, NextEra could be in a position where it will be required to put large amounts of capital into this fund in a short period of time to meet NRC requirements. The Board has been proactive in insuring that while IPL owned DAEC, there were sufficient funds coming from rates to keep this fund at sufficient levels.

Consumer Advocate is correct that once the DAEC PPA expires, IPL may face upward pricing pressure to replace the capacity from the DAEC PPA. As carbon issues become bigger and legislation is ultimately passed, the generation from a nuclear plant is likely to become more valuable due to its near emissionless production. IPL witness Aller testified that IPL is currently in negotiating with NextEra on an extension, the rates in any new contract are likely to be much more expensive than the current rates. (Tr. 154)

Clearly, the Board cannot change the outcome of the DAEC sale. Relicensing was not an option that was presented to the Board in Docket No. SPU-05-15.

The options presented to the Board were to either sell the plant or decommission it once the license expired. After IPL agreed to put the sale proceeds in a regulatory liability account to offset AFUDC for future generation, the cost-benefit analysis showed a significant advantage to selling versus decommissioning in 2014. The Board was very adamant in the Order allowing the sale of DAEC to proceed that it believed that IPL should have more strongly considered the relicensing option. However, since this was not an option in the case, it was not an option the Board could choose.

While there were both positives and negatives associated with the sale of DAEC, the proposed sale, as it was presented in Docket No. SPU-05-15, was determined by the Board to be reasonable. On November 30, 2005, the Board issued an order closing the docket allowing the sale of DAEC to proceed.

Staff Conclusion

The sale of the DAEC was allowed by the Board after a thorough analysis. Based on the record in Docket No. SPU-05-15, selling the plant was a better option than closing it in 2014. While the Board would have liked to have had a better analysis relating to IPL relicensing the plant and continuing ownership, this option was not offered. There is nothing in the record that would indicate that customers have been adversely harmed by the sale up to this point in time. It is not possible to determine the impacts that the sale of DAEC will have on future rates. IPL has put itself in a position that it has nearly no alternatives but to extend the DAEC PPA. The costs associated with this extension will clearly affect future rates.

Staff does not believe that IPL should be penalized for the sale of DAEC. However, IPL has put itself in a position of critical need in regards to the future of the DAEC PPA.

4. ITC Midwest Sale – Docket No. SPU-07-11

Consumer Advocate argues IPL expected the sale of its transmission system to cause only a slight increase in costs and these costs would be offset to some degree by funds from the ATA.[1] In reality, IPL's transmission costs have increased dramatically and the entire proceeds from the ATA will offset only the 2008 true-up amounts and a small amount of the 2009 increase. (This is IPL's proposal.)

[1] The ATA was designed to provide $13 million/annually for eight years from the sale proceeds to offset the increases in transmission due to the variance in the IPL and ITC Midwest allowed ROE's. In addition, ITC Midwest offered to reduce its revenue requirement by $4 million/annually for eight years to offset cost increases. IPL has proposed to bring the entire proceeds that were to be used over eight years, into the first two years in order to offset the 2008 true-up levels. This adjustment is discussed in a separate section.

IPL argues it had considered moving out of the transmission business for several years and had concluded that with the emerging wholesale and renewable market, the necessary investments would be substantial and better dealt with by an independent transmission company. IPL very clearly stated that the purpose of the ATA was to insure that customers would not be financially harmed from the transfer of IPL's existing transmission assets from the Board's jurisdiction to FERC jurisdiction, and the corresponding increase in ROE.[2] The additional increases resulting from ITC Midwest's expansion and maintenance programs were not included in the cost-benefit analysis. Staff would note that ITC-Midwest did not provide any estimates of projected spending or any maintenance plans during the Docket No. SPU-07-11 proceeding. ITC Midwest stated that no plans would be put together until the sale was finalized.

IPL is correct in stating that the Energy Policy Act of 2005 provided incentives designed to encourage the divestiture of transmission assets to independent transmission companies. The advancement of the wholesale and renewable markets led to the need for additional transmission spending. ITC-Midwest committed to making the investments necessary to provide a robust transmission system to the customers of IPL and to the entire region. This was a commitment that IPL was evidently not willing to make.

Staff Conclusions

The question remains as to the level of blame that should be put on management for not knowing, or for failing to take the time and effort to be able to indicate how dramatic the cost increases would be, not after the fact, but prior to the SPU-07-11 proceeding. IPL was clearly blindsided by the cost increases that it has seen from ITC Midwest. IPL is arguing this point at FERC.

IPL has indicated that it did not know what its cost increases would be and only estimated a small increase in Docket No. SPU-07-11. However, staff believes that IPL management was negligent in not insisting that ITC Midwest provide a preliminary work plan and preliminary cost estimates for at least the first five years of ownership. In addition, IPL clearly knew, or should have known, the condition of the system being sold to ITC Midwest. Considering that the vast majority of capital being investing by ITC Midwest is for maintenance rather than expansion, the condition of the IPL transmission system must not have been very good at the time of the sale. Staff believes that IPL management should have done more to determine the future impacts on customers as a result of the transmission sale.

ITC Midwest is doing maintenance that could and probably should have been done by IPL over the past several years. By delaying maintenance, costs for materials and labor have increased, and the associated return given to ITC

[2] The current authorized ROE of IPL is 10.7 percent while the allowed return for ITC Midwest is 12.38 percent.

Midwest vs. what IPL earns is also higher. Both of these points fuel the higher costs being charged to IPL.

Staff believes that if the Board determines that a penalty is appropriate, it would be appropriate to consider the negligence shown by IPL in managing the sale of its transmission system as a condition for penalty.

5. Holding Company Investments

Consumer Advocate argues that poor investment decisions at Alliant in the 1990's and early 2000's had an influence on the decisions made at IPL. In addition, the sale of DAEC and the IPL transmission system provided Alliant an opportunity to trade assets earning regular returns for assets that could potentially get inflated HF 577 returns.

IPL witness Aller acknowledges that Alliant made several investments that were not profitable. He also indicated that beginning in 2002, AEC decided to liquidate its foreign investments and refocus on its core utility businesses. Witness Aller stated that all foreign investments were liquidated prior to 2007. The test year in this case is based solely on the operations of IPL.

While it is possible that the losses at Alliant could have affected the decision making at IPL, it would be very difficult to determine what if any correlation existed and how these losses affected the decision making at IPL.

Staff Conclusion

Staff does not believe there is any significant evidence in the record that would indicate that investments at the holding company level directly impacted the decisions at the utility level. However, staff would commend Alliant for refocusing on the utility business rather than on non-regulated investments.

6. Use of DAEC and ITC Midwest Sale Proceeds

Consumer Advocate argues that the sales of DAEC and the IPL transmission system provided AEC two ways to improve EPS. First, replacing depreciated assets returning regular returns with new assets earning inflated returns received under HF 577 would provide additional earnings and boost EPS. Second, using the proceeds from the sales to repurchase stock while maintaining earnings would increase EPS. Both of these options would increase management bonuses that are tied to EPS.

Staff Conclusion

Staff believes that it is likely that part of the decision to sell DAEC and the transmission system included the opportunity to replace depreciated assets

returning regular returns with new assets that could potentially earn guaranteed inflated returns. While this may not be the intent of HF 577, there is nothing in the statute that would forbid this type of strategy.

Final Conclusions

In order to determine if a penalty is warranted, the Board will need to be persuaded that IPL management has performed at a level that would be considered poor. Average management performance is not considered grounds for penalty. Staff believes that it would be very difficult to base a penalty solely on the sale of either DAEC, as presented, or the IPL transmission system, as presented, since both were completely litigated before this Board. In addition, the mere argument by Consumer Advocate that a penalty should be imposed due to IPL's rates being higher than MEC's is questionable due to factors that occurred many years ago.

However, staff believes there are areas of concern that could potentially show that a penalty is warranted, including:

1. Did IPL neglect its transmission system knowing it was going to be sold?

If this is true, did this neglected maintenance and upkeep get shifted to ITC Midwest who in turn is performing work that should have been done by IPL over the past several years? The additional cost of delaying maintenance could result in inflated damage during storms, as well as higher costs and returns from ITC Midwest vs. IPL doing the work at the time it should have been done. In addition, was IPL management negligent in not pursuing information for ITC Midwest relating to future work plans and corresponding cost increases to IPL.

Staff believes that since the majority of cost increases coming from ITC Midwest are the result of maintenance rather than expansion, one could logically conclude that the IPL transmission system was in significant need of attention at the time of the sale. The added cost to customers from this maintenance comes from the likelihood that current costs are higher than they would have been in past years under IPL ownership, and from the substantially higher ROE that ITC Midwest receives (12.38) vs. the embedded ROE that IPL receives (10.7).

IPL indicated in Docket No. SPU-07-11 that cost increases would not be a significant factor in the sale to ITC Midwest and stated that any increases would be small. While this increase was based only on the current system, and did not include any additional rate base increases by ITC Midwest, there was nothing in the record to indicate that costs would increase substantially. IPL witness Aller indicated that IPL had no idea that these significant cost increases would be as large as they are. (Tr. 18) Staff believes that if the president of a company is not aware of multimillion dollar cost increases that result from a management decision, management didn't adequately do their job. IPL customers are now at the mercy of ITC Midwest and the costs that they pass along. While staff has no

issues with ITC Midwest doing the job they agreed to do, IPL failed to adequately do its work prior to agreeing to the sale.

2. Did IPL neglect its need for adding capacity for a long enough timeframe that the dependence on the purchased power market will require customers to pay higher costs than if generation had been constructed over the past several years?

Including the DAEC PPA, IPL is currently purchasing approximately 40 percent of its capacity needs. This makes IPL very dependent on the wholesale market and leads to two possible issues. First, if purchased power costs rise, IPL will be forced to pay the higher prices since there are no obvious alternatives. Second, if purchased power costs rise, and the DAEC contract is not extended, IPL will likely be in great need of baseload capacity. Since baseload is generally either coal or nuclear in this region, it will likely be very difficult and very expensive to build either type. Since IPL sold its nuclear plant and chose not to build a coal plant, there is no clear option to meet future baseload needs other than through purchases. Staff understands that IPL is installing wind capacity. However, wind will not replace either the coal or nuclear capacity that was dropped by IPL management.

While it is true that IPL has put itself in a position that it is very dependent on the wholesale market, there is no clear evidence that shows that IPL would have lower rates if it had constructed generation. However, since IPL's generating fleet is rather aged, and the costs of replacing generation are significant, it is highly likely that future costs will only increase due to higher maintenance costs, lower reliability at current plants, and the continued dependence on the wholesale market. In addition, staff believes that IPL has put itself in a position where the extension of the DAEC PPA is critical.

IPL witness Aller indicated that it is likely that a baseload natural gas facility would be the likely next addition to the IPL baseload fleet. (Tr. (155) While this option would address future carbon issues, it would put IPL at a much greater risk for future fuel cost spikes due to the volatility of the gas market. In addition, staff believes that IPL should be commended for increasing their emphasis on wind generation. However, while wind is a great resource, it is not a baseload option and will not replace the aged coal facilities in IPL's generating fleet.

Recommendation

Staff believes that if the Board determines that a penalty is warranted, it should not be at the level proposed by Consumer Advocate but more in line with the proposal of the ICC (ICC proposal is 30 basis points). In addition, the Board would need to determine if any penalty should be carried forward to IPL's 2010 rate case. Not requiring inclusion would significantly decrease the actual penalty since IPL will likely implement 2010 temporary rates within three months of final

rates in this case being implemented. The easiest way to include a penalty in the 2010 case would be to require an adjustment that reduces the revenue requirement by the penalty amount.

The management efficiency statute briefly discusses energy efficiency as being a factor in a utility showing good management practices. Clearly, IPL has done a good job with its energy efficiency programs. Staff believes that IPL should be commended for their energy efficiency programs.

Transmission Issues

ATA Cost-Benefit Analysis and whether any Transmission Cost Adjustments are Warranted

Staff Introduction: On these subjects, Consumer Advocate primarily focuses on the SPU-07-11 cost-benefit analysis and IPL's commitments in that case. ICC challenges the reasonableness of the increases and in particular argues that, other than the true up of 2008 costs, no transmission adjustments should be allowed because 2009 and 2010 ITC-M rates are not known and measurable yet and their inclusion in this rate case would cause collection of more than one year of transmission costs within a single test year.

IPL Initial

Initial Brief: pp. 34-47

OCA argues that IPL should not recover more ITC-M costs than those included in the ATA cost-benefit analysis. (Tr. 863) However, OCA does not disagree that the 2010 costs are allowable adjustments pursuant to Board rules.[3] In summary, OCA wants all (2008, 2009, 2010, and 2008 true-up) costs capped at the levels in the transmission sale Applicants' ATA cost benefit analysis. (Tr. 447-448) Under this treatment, IPL would suffer a long-term impairment since the OCA suggests maintaining this cap through 2016. (Tr. 952)

ICC contends 2009 ITC-M costs are not "known" (Tr. 1295, 1324-1326) and 2010 costs are outside of the test year and are speculation (Tr. 1287). ICC's recommendation, to only allow 2008 trued-up costs ultimately reduces IPL's requested revenue requirement by $40.8 million in lower ITC-M costs. (Tr. 77)

ITC-M rates are subject to the exclusive jurisdiction of the FERC in an authorized rate/tariff that IPL is obligated to pay. (Tr. 75) Mr. Fuhrman acknowledged IPL

[3] IPL's brief did not provide citations for this statement. The closest discussion appears to be with OCA witness Fuhrman Tr. 954. Here and Tr. 915, in his rebuttal testimony, OCA witness Fuhrman's position seems to be that FERC-approved rates are reasonable and that IPL may be obligated to pay, but that the commitments made by IPL through the ATA cost-benefit analysis should provide a cap for the level of costs for customer liability.

has no choice but to pay (Tr. 877), and that ITC-M charges are according to the FERC-approved tariff and thus are reasonable expenses (Tr. 915). IPL cannot purchase transmission service from a different provider and must take ITC-M service to provide power and energy to Iowa retail customers. (Tr. 77)

The Board has no legal authority to change ITC-M rates or ITC-M's revenue requirement that is the basis for its rates. Under Iowa Code Section 476.33(4), the Board must allow recovery of ITC-M costs IPL incurs or will incur within 12 months of the filing of IPL's rate application.

IPL's rate increase request is not inconsistent with Docket No. SPU-07-11 commitments. Mr. Fuhrman provided no evidence to the contrary, because IPL has lived up to its commitments.[4]

OCA argues that allowing transmission costs to exceed the Applicants' cost-benefit analysis allows IPL to dishonor its commitment to hold customers harmless. (Tr. 448) The purpose of the ATA cost benefit study was to hold customers harmless from the transfer of transmission assets from Board to FERC jurisdiction, not to shield customers from cost increases due to ITC-M's expansion of the grid or O&M and A&G costs. (Tr. 80) OCA misunderstood, overlooked or ignored that the ATA cost-benefit analysis assumed ITC-M would operate the system in the same manner as IPL, and therefore that capital spending, O&M and A&G would be the same. (Tr. 450)

At hearing, IPL witness Hampsher explained the baseline revenue requirement (BLRR) as transmission costs if IPL were to continue to own and operate the assets; the post transaction revenue requirement (PTRR) includes the additional costs if assets were transferred to ITC-M and subject to FERC jurisdiction. Four additional costs were quantified. The FERC would allow (1) a higher ROE, (2) a higher percentage of common equity in the capital structure, and (3) higher cash working capital; and (4) there would be a rate base loss of the accumulated deferred income taxes that could not be transferred to the buyer. The ATA was to hold ratepayers harmless for those first two levels of costs. New costs from investments to rebuild and upgrade the system were not quantified in the ATA analysis. (Tr. 506-510)

IPL felt like there would certainly be different levels of O&M and A&G once the transmission company came into effect and had its singular focus and began much greater investments. IPL knew that there would be higher O&M and A&G costs, but that was not factored into the cost-benefit analysis, by design. (Tr. 506-510)

[4] IPL states that its commitments were: (1) limit the common equity in IPL's next electric rate case to no more than 50 percent; (2) IPL to make eight cash refunds of $13 million per year; (3) ITC-M to make eight rate discounts of $4 million per year; and (4) ITC-M would not seek recovery of the first $15 million of expenses associated with the sale. (Tr. 449).

Mr. Fuhrman's rebuttal testimony states that he interpreted IPL's "hold harmless" language as essentially a guarantee shielding IPL's customers from paying for ITC-M's increased transmission investments (Tr. 909-913), and that the Board expected the ATA to provide protections beyond assumptions included in the cost-benefit analysis (Tr. 913-914) However, in the OCA's appeal of the Board's SPU decision, he advised the Polk County District Court that ITC-M's Attachment O would far exceed the impact to IPL and its customers as presented in the IUB proceeding. (Tr. 955-956)[5] He did not advise the Court that IPL had promised to hold its customers "harmless." (Tr. 956) Mr. Furhman's arguments in this case are inconsistent with his statements to the Polk County District Court. The Board understood the ATA's purpose, as shown in the Board's argument in the appeal that "There's no need for remand to take additional evidence because the OCA's new evidence is not a significant departure from the costs contemplated by the Board when it reviewed the proposed transaction." (Tr. 964)

The OCA's recommendation to cap transmission costs unfairly penalizes IPL by disallowing legitimate transmission expenses. Customers should be expected to pay for prudent transmission investments and related expenses. (Tr. 452-453) Exhibit CAH-2, Schedule H shows more than $115 million of capital additions at the end of 2009 above levels presented in the SPU cost-benefit analysis. This is not surprising because ITC-M witness Welch emphasized the increased investment ITC-M was prepared to make. This investment increased ITC-M's 2009 Attachment O revenue requirement by over $23.8 million (IPL-Iowa). (Tr. 453-454) Also, IPL witness Bauer explained that NERC standards are much tougher [than during the SPU timeframe], and ITC-M's maintenance policies explain higher O&M in ITC-M's 2009 Attachment O. (Tr. 207, 457)

Customers should be expected to pay increased ITC-M costs. To do otherwise is to provide a newer, expanded, robust transmission system to IPL customers at no cost to them. To escape the inevitable conclusion that disallowing actual and reasonable costs denies IPL the opportunity to earn its authorized return, Mr. Fuhrman suggests IPL use the gains from the transmission sale to offset ITC transmission expense. (Tr. 877) The gain from the sale was recognized in 2007. (Tr. 459) There is no legitimate way to pay ITC-M costs from sale proceeds. All that remains are cash proceeds from the sale, some of which have been reinvested in IPL infrastructure and the rest will be reinvested in future IPL infrastructure. OCA essentially suggests an equity infusion from the parent to pay operating expenses. (Tr. 80) Mr. Furhman was uncertain about tax consequences of his proposal, and conceded that Mr. Hampsher's accounting criticisms were valid.[6] (Tr. 958-962) To spend equity dollars to pay reasonable operating expenses is pure folly and would weaken IPL's equity ratio, a

[5] This discussion refers to the impact of ITC-M's 2009 Attachment O, the first new rate following the transmission sale.

[6] IPL notes that the Board's Order made clear that the tax deferral requires IPL to reinvest the entire transmission sales proceeds within four years. (SPU-07-11, September 20, 2007, Order pp. 5-6, 70.)

circumstance that contributed to the Board's management efficiency penalty against Great River Gas in Docket No. RPU-86-12.

Consumer Advocate Initial

Initial Brief: pp. 2-8, 12

IPL's four pro forma adjustments are intended to recover from customers all of the higher transmission expense for ITC-M rates. OCA witness Fuhrman concluded these adjustments should be rejected as wholly inconsistent with a critically important and unconditional commitment to hold retail customers harmless from any rate increase effects resulting from the transmission sale for at least eight years, made by IPL in Docket SPU-07-11. (Tr. 861-863, 909, 914) In Docket No. SPU-07-11, IPL made this commitment in the sworn testimony of IPL witness Larsen (Tr. 911); through revenue requirement amounts submitted by IPL witness Hampsher (Ex. CEF-1, Sch. A, p. 1, line 2) that dramatically understate ITC Midwest's actual revenue requirements for 2008-2010; through assurances in IPL's initial and reply legal briefs; and through IPL's failure to file an application for rehearing to correct what it now claims is a misconception that customers would actually be held harmless for eight years. At page 30 of its reply brief, IPL stated: "The ATA shields IPL's full requirements customers from any expected ratepayer impact resulting from the sale of IPL's transmission assets to ITC-Midwest for at least eight years and potentially for 20 years." (Tr. 118) Based on these assurances, the Board permitted the sale.[7] IPL took no action to inform the Board that IPL's hold harmless assurances were, in fact, meaningless empty promises dependent on the accuracy of Mr. Hampsher's PTRR estimates.

IPL did not inform the Board that customers would be subject to significant rate increases during the eight year period following the transaction, notwithstanding its hold harmless assurances. (Tr. 121-122, 512) Apparently, IPL believed that holding customers harmless for eight years would cost shareholders nothing.

IPL essentially promised transmission costs based on its share of ITC-M PTRR estimates for 2008-2010.[8] IPL's adjustments proposed in this case are inconsistent with commitments made in the transmission sale to hold customers harmless for at least eight years and therefore should be rejected.

OCA proposes three much smaller adjustments consistent with IPL's hold harmless commitments, essentially requiring IPL's shareholders to absorb the costs. This is not unfair to shareholders because they received an after-tax gain on the transmission sale of over $218 million. (Tr. 878, 527) It is unfair to allow

[7] OCA refers to the Board's September 20, 2007 Order, pp. 30, 40-41, 43-45.
[8] For 2008-2010, OCA compares IPL's PTRR estimates in SPU-07-11 to the adjustments IPL presented in this case: 2008 ($104.1 million vs. $141.8 million including the true-up), 2009 ($109.27 million vs. $153.71 million), and 2010 ($113.75 million vs. $156.17 million).

IPL to renege on its hold harmless assurances, forcing costumers to pay dramatically higher transmission costs, while shareholders keep a handsome profit. (Tr. 528-529) When IPL made these statements, it knew or should have known that shareholders would be at risk for ITC-M costs that substantially exceeded the SPU-07-11 estimates.

ICC Initial

Initial Brief: pp. 5, 10-13

Transmission expenses should be limited to actual costs incurred by IPL for the test year. The only known and measurable adjustment for 2008 is the true-up amount ($46.9 million) (Brubaker Direct, p. 9) Any adjustment for ITC-M costs must be kept in the context of the original IPL - ITC-M relationship and the promises made to IPL customers. OCA and IPL customers (including ICC) warned of the potential for costs to be substantially higher than IPL or ITC-M admitted. IPL and ITC-M vigorously defended their relationship and the terms of the transaction. (Brubaker, Direct, p. 7) It is wholly inappropriate for IPL to be allowed to pass through the higher costs it steadfastly denied in the prior proceeding and unjust for IPL's customers to pay for IPL's mistakes.

The test year for this rate proceeding is 2008. ICC proposes that IPL be permitted to collect actual 2008 expenses. Whether ITC-M's rates are exclusively FERC's jurisdiction is irrelevant. The Board has the authority and responsibility to regulate IPL's retail rates. IPL witness Aller claims allowing anything less than ITCM's costs would be "confiscatory" and "in violation of law." Mr. Aller is not a lawyer, cannot make those legal conclusions, and offers no citations or evidence.[9] (Tr. 138-139) IPL revenues are not segregated for ITC-M related expenses; denying further adjustments does not infringe on FERC rate jurisdiction and provides IPL an appropriate incentive to aggressively manage its costs. (Tr. 139-140)

IPL has not made its case for other adjustments, and IPL should bear the consequences of its decision to divest itself of its transmission system. IPL can seek to recover – and justify – additional higher costs in future proceedings.

IPL Reply

Reply Brief: pp. 5-6

OCA's arguments were anticipated and rebutted in IPL's initial brief. OCA's primary argument is that IPL committed, through the ATA, to "hold its retail customers harmless from any rate increase effects resulting from the transmission sale for at least eight years." (OCA Brief p. 4)

[9] ICC also cites Aller, Rebuttal, page 4.

IPL's Initial Brief explained the purpose of the ATA, related to the transfer of transmission assets to FERC jurisdiction. The ATA cost-benefit analysis specifically excluded new construction by ITC-M. Also, Mr. Fuhrman did not advise the Polk County District Court that IPL promised to hold its customers harmless from ITC-M's 2009 rate increase. This OCA interpretation arose only after the OCA lost its appeal in SPU-07-11.

Consumer Advocate Reply

Reply Brief: pp. 1-5

In SPU-07-11, IPL made a commitment to the Board to hold retail customers harmless from any rate increase resulting from the transmission sale for at least eight years. Sworn testimony of a company vice president stated the transaction structure and that IPL commitments would essentially "zero out any rate increase effects" over the first eight years. (Tr. 911) The commitment was also described in IPL's initial and reply briefs and was unqualified.[10]

In this proceeding, IPL now states the hold harmless commitment was never intended to protect customers from all rate increase effects such as actual O&M costs, actual A&G costs, and costs resulting from ITC-M's expansion of the grid being higher than those in the cost-benefit analysis submitted to the Board.[11] Throughout SPU-07-11, IPL described projected O&M and A&G costs as "reasonable."[12] Had IPL included a more realistic level of costs, the Board's decision may have been different.[13]

IPL's hold harmless commitment essentially contemplated that IPL shareholders would absorb, for eight years, any rate increase impact that exceeded the cost-benefit analysis assumptions. This result does not call FERC-approved rates into question, undermine federal law or violate filed rate doctrine. To the contrary, allowing IPL to worm out of its eight-year hold harmless commitment would undermine the reorganization provisions of Iowa Code Sections 476.76 and 476.77 and the integrity of the regulatory process.

Staff Analysis

Essentially, the parties disagree on the meaning and veracity of the ATA cost benefit analysis, the meaning of statements that customers would be "held

[10] Consumer Advocate cites Tr. 114-118, 510-511.
[11] Consumer Advocate cites IPL Initial Brief, p. 38.
[12] Consumer Advocate cites IPL Initial Brief in SPU-07-11 at 52-54.
[13] Consumer Advocate cites the Board's Order in SPU-07-11 (IUB, Sept 20, 2007) at 46: "It is clear that the proposed transmission sale would have some impact on reducing IPL's A&G expenses, but it is less clear what the amount of those savings might be." Staff believes this is taken out of context; this discussion was really only addressing that some things formerly done by IPL would now be done by ITC-M and flow through those rates, so that some contributing component to direct IPL A&G would be reduced.

harmless" as a result of the SPU-07-11 ATA refunds and the clarity of IPL's presentation in the SPU that additional ITC-M investment could substantially raise rates. OCA argues to cap ITC-M costs at those modeled in the ATA cost-benefit analysis. IPL presented extensive legal precedent it feels is applicable to the treatment of transmission costs in this case, concluding essentially that the Board must allow recovery of FERC-jurisdictional ITC-M transmission costs.

ICC argues that 2009 and 2010 ITC-M rates are not known and measurable until the true up is calculated; the ICC proposal, then, follows that logic in applying the 2008 (2010) true-up as the only ITC-M adjustment, but applying it in full rather than amortizing it over four years. Further, ICC argues that allowing the 2009 adjustment and the true up for 2008 costs allows IPL to double collect the 2008 costs in rates.

In general, and as discussed later, staff disagrees that current (2009) posted Attachment O transmission rates are not known and measureable. Staff believes that, to the extent they meet the criteria in Board rules for consideration, the adjustments for 2009 and 2010 rates would not result in collecting more than a year of transmission expense. The 2008 true up, applied to 2010 rates, could otherwise be argued as overcollection, as ICC does, except that the 2008 rate remained at IPL's 2007 (historic 2006) level, subject to later true up by ITC Midwest's tariff, and the true up will actually be paid by IPL in 2010.

The ICC argument also appears to contemplate the difference between costs and rates – that is, ***rates*** are known, but ***costs*** (based on usage) are not. Regardless of the result, staff believes the distinction in this case is of little importance because the transmission owner is essentially guaranteed a revenue requirement with true up later. No other parties supported ICC's position in this issue.

Although Consumer Advocate highlights the lack of prudence in transmission cost projections and the misstatement by IPL witness Larsen, staff is not convinced that the "hold harmless" protection was assumed by parties to include all increased investment by ITC-M. In fact, ITC-M cost increases could be expected if the increased investment benefits were anticipated.[14] Staff does not believe the Board's decision in the transmission sale assumed this level of protection.

However, in the case by Applicants for the transmission sale, the lack of focus on retail customers and resulting costs to date are troubling. IPL did a poor job of estimating the potential impact of new ITC-M investment, did an inadequate prudence review on behalf of its customers for these potential costs, and did not challenge ITC-M rate and tariff elements during or after the sale in a manner that

[14] More cynically, increased investments and costs should have been anticipated following a transaction where the buyer paid much greater than book value for assets and agreed to forgo placing that higher value in rate base.

could have better protected its customers.[15] In the first two years since the sale, ITC-M costs have risen dramatically.[16] In fact, it appears IPL was even surprised by the amount of the cost increases.[17] IPL's proposals for test year adjustments, placing the true-up balance in rate base, and a transmission cost adjustment rider allow IPL virtually full recovery of these costs since the transaction and shift the full risk of any other increases to ratepayers.

Whether a management efficiency penalty is warranted for these or other reasons is discussed elsewhere in the memo. Also, depending on the Board's acceptance of IPL proposals, the lower company risk associated with IPL's transmission cost recovery since the transmission sale could justify an ROE adjustment to what would otherwise be awarded.

2009 Transmission Costs Adjustment

IPL Initial

Initial Brief: pp. 31-32, 48-50

IPL pays FERC approved transmission rates for transmission required to serve its customers. IPL makes three adjustments to establish proper transmission costs: transmission costs that IPL will incur in 2009; the treatment of the 2008 true-up amount; and ITC-M's 2010 rates that will be paid beginning January 1, 2010.

Schedule B-9 is IPL's 2009 adjustment. Virtually all of these increases are related to the change in ITC-M's 2009 tariff rate, which is known and measurable and commenced January 1, 2009. The resultant increase is $58.4 million (Iowa portion). (Tr. 355-356)

ICC's position that transmission costs are only known when published in the FERC Form 1 is irrelevant because IPL pays based on ITC-M's Attachment O rate approved by the FERC, based on forecasted (not historic) ITC-M costs. (Tr. 462-463) Though subject to true-up, the rate is "known and measurable" as the only rate that ITC-M can collect in 2009. IPL must pay this rate in 2009. It has been known since September 2008 and must be accepted by the Board for IPL to make a legitimate test year adjustment. (Tr. 463)

Consumer Advocate Initial

[15] Specifically, IPL did not oppose at the FERC, and did not engage in meaningful discourse until after it was approved, ITC-M's implementation of a policy to reimburse interconnecting generators for 100% of transmission network upgrade costs FERC Docket No. ER08-796-000. (Tr. 840)
[16] Consumer Advocate compares IPL's PTRR estimates to the adjustments IPL presented in this case: 2008 ($104.1 million vs. $141.8 million including the true-up), 2009 ($109.27 million vs. $153.71 million), and 2010 ($113.75 million vs. $156.17 million). OCA Initial Brief at 8.
[17] IPL challenged ITC-M's 2009 rate at the FERC in Docket No. EL09-11 and successfully petitioned ITC-M to voluntarily reduce 2009 O&M by about $10 million. [Aller, Direct, pp. 17-18.]

Initial Brief: pp. 10

Consumer Advocate compared "hold harmless" ITC-M charges for 2008 and 2009 presented in the SPU, determined the Iowa-electric portion, and added allowable non-ITC-M transmission related costs (undisputed) to arrive at an alternate 2009 adjustment. The 2009 pro forma adjustment should be $2.79 million. (Exhibit CEF-1, Revised Schedule B, p. 1, column b, line 10)

ICC Initial

Initial Brief: pp. 5-8

Transmission expenses should be limited to actual costs incurred by IPL for the test year. IPL first adjusts the 2008 test year by $58.4 million for the increase from 2008 booked to 2009 projected rates (reflecting both 2008 booked to 2008 actual and higher 2009 cost of service), then by $17.5 million for a best-guess estimate of what ITC-M rates will be January 1, 2010. Then, IPL proposes to collect the $46.9 million true-up for 2008. The $46.9 million is already reflected in the $58.4 million increase in ITC-M rates 2008 to 2009 since that includes the difference between 2008 booked and 2009 projected actual transmission expense. This results in IPL's revenue requirement collecting more than a year's worth of transmission expense.

IPL's revenue requirement for transmission should reflect no more than its actual 2008 transmission expense.

Fundamentally, the Board must ensure rates are "just and reasonable" and use "judgment and common sense in setting rates."[18] ITC-M's 2009 rates are in effect until actual 2009 costs are known. IPL concedes the 2009 tariff rate is based upon mere "projections," and over or under charge will be built into the 2011 tariff rate. (Hampsher, Rebuttal, p. 35) IPL challenged ITC-M's 2009 formula rate in FERC Docket EL09-11, claiming ITC-M proposed excess costs and that its unjust and unreasonable charges will harm IPL and its customers.[19] The 2009 rate is subject to dispute and change, and is inappropriate to include as a test year adjustment.

IPL Reply

Reply Brief: pp. 6-8

[18] ICC references Interstate Power and Light Co., Final Decision and Order, Docket Nos. RPU-02-3, RPU-02-8, ARU-02-1, at 19 (April 15, 2003).
[19] ICC cites IPL v ITC Midwest, Complaint, FERC Docket No. EL09-11-000, at 1 (filed Nov 18, 2008).

The ICC incorrectly states IPL double-counts the $46.9 million true-up. The $58.4 million increase (2009 over 2008) is not the result of summing the $46.9 million true up and $11.5 million of increases in sales and costs. The $58.4 million does not include any of the 2008 true up. IPL witness Hampsher explained he agreed with the numbers but not explanation. (Tr. 538)

ITC-M's 2009 rate is the only rate ITC-M can collect in 2009 and is the rate IPL must pay in 2009. It has been known since September 2008, in effect since January 1, 2009, and must be accepted the Board for IPL to make a legitimate adjustment to the test year transmission expense.

IPL's testimony placed OCA and ICC on notice that their proposed level of transmission costs "are confiscatory and in violation of the law." (Tr. 48) Reasonable and just rates require that IPL recover its actual transmission costs. ITC-M costs are now vested in FERC and are, as a matter of law, prudently incurred costs the Board is obliged to allow IPL to recover. (IPL 60)

Consumer Advocate Reply

Staff Note: In reply, Consumer Advocate reiterates its hold-harmless argument. Its proposed adjustments, if the Board accepts this position, are summarized in a table in later staff analysis.

ICC Reply

Reply Brief: pp. 1, 4-8

IPL's "Legal Authority" discourse does not address ICC's fundamental question – whether IPL should collect over a four-year period the $46.9 million true up for 2008 while simultaneously proposing an adjustment to its 2008 test year that recognizes the same true up. IPL apparently misunderstands its own transmission expense claims.[20]

The Board should not be misled by IPL that IPL's four-year amortization proposal results in a smaller rate impact than ICC's proposal for "the whole amount of this large $50 million underbilling" to be reflected in final rates.[21] IPL's proposal is hardly a benign approach because that "large $50 million underbilling" is also reflected in IPL's proposed adjustment for 2009.

[20] ICC briefly explains two issues. First, it reiterates its position that the$46.9 million true up is already included in the 2009 adjustment and it should not be allowed twice. Second, it challenges IPL's contention that it "will never be able" to recover approximately $15 million of the increase in IPL's costs from 2008 to 2009 since "IPL was not able to implement interim rates until the end of the first quarter." (IPL Initial Brief at 120)

[21] ICC cites IPL Initial Brief at 50.

IPL's "Legal Authority" section is not dispositive. The upshot is that states may not interfere with FERC-jurisdictional approved rates. ICC does not propose disallowing ITCM's costs. ICC asks the Board to allow in IPL's revenue requirement only those costs that are known, quantifiable, and measureable for the 2008 test year. The issues of how and when the Board establishes IPL's retail rates and inclusion of ITC-M rates does not interfere with FERC-approved rates.

ICC recommends allowing the underbilling once as an adjustment to the 2008 test year and no further adjustments. ICC maintains that 2009 and 2010 costs are uncollectible because they are not known and measurable.

Staff Analysis

The ICC proposal was clarified in brief. ICC recommends allowing the underbilling once as an adjustment to the 2008 test year, which would result in what ICC calls a "trued-up 2008 test year," and no further adjustments. This could: (1) cause regulatory lag of at least one year for transmission cost changes and tend to produce more frequent rate cases; (2) be inconsistent with IPL recovering costs for each year that may be legitimate, and (3) complicate or possibly be incompatible with any transmission cost recovery rider, because it would require backing out the true-up adjustments from the actual FERC-approved transmission rates in place two years later.[22]

Consumer Advocate's alternative 2009 adjustment, calculated as a cap based on its interpretation of IPL hold-harmless commitments, is included in a table later in this memo. ICC (and others) noted that IPL has contested ITC-M's 2009 rate as excessive and lacking support.[23] While subject to challenge and refund, these rates are currently in effect under FERC authority.

IPL is currently paying 2009 ITC-M rates and has been since January 1, 2009 – prior to the filing of this rate case. Staff believes this rate is known and measurable, not likely subject to change during the course of the year, subject to true up as part of a FERC-approved forward-looking transmission rate, and satisfies the Board's rules for items that shall be considered for adjustments to a test year.

2010 Transmission Costs Adjustment

IPL Initial

Initial Brief: pp. 33-34, 49

[22] Other either parties do not support or do not address the double-counting argument of ICC.
[23] Brubaker, Direct, 9-11.

Schedule B-26, similar to the 2009 adjustment, is IPL's adjustment for ITC-M increases in 2010. IPL proposes recovery because these ITC-M rates were known and measurable when they were posted in its Attachment O in September 2009. This is within 9 months of the end of the test year and billing will begin January 1, 2010, within 12 months of commencement of the case. IPL has separated the true-up portion of this rate from the normal change. (Tr. 372-373)

Consumer Advocate Initial

Initial Brief: pp. 11

OCA compared "hold harmless" ITC-M charges for 2009 and 2010 presented in the SPU and determined the Iowa-electric portion to arrive at an alternate 2010 adjustment. The 2010 pro forma adjustment should be $4.21 million. (Tr. 876-877; Exhibit CEF-1, Revised Schedule B, p. 1, column b, line 10)

ICC Initial

Staff note: Relevant ICC positions are in previous sections and not duplicated here.

IPL Reply

Reply Brief: p. 7

ITC-M's 2010 rate meets the Board's "known and measurable" standard since it was known in September 2009, within 9 months of the test year, and will be incurred within 12 months of IPL's March 17, 2009 filing.

Staff Analysis

Consumer Advocate's alternative 2010 adjustment, calculated as a cap based on its interpretation of IPL hold-harmless commitments, is included in a table later in this memo.

Staff believes that ITC-M's 2010 rate is essentially known and measurable now, subject to true up as part of a FERC-approved forward-looking transmission rate, and unlikely to change if a decision is deferred.

Option 1: IPL will be paying ITC-M 2010 rates effective January 1, 2010. Staff believes this rate is known and measurable, is not likely to change during the course of the next year, and could satisfy the Board's rules for an adjustment to the test year that shall be considered.

Option 2: On the other hand, General Counsel advises that the Board must consider, but is not required to accept, adjustments that are known and

measurable within nine months of the test year and in effect within twelve months of the initial filing of the rate case. The 2010 rates only narrowly meet the guidelines for known and measurable within 9 months of the test year and in effect within 12-months of commencing the rate case. Although unlikely, the rate could change through challenge or error. Additionally, although the rate is known and being incurred, only a portion of the expense is incurred within the 12 month window and prior to IPL's next rate case. Staff believes the Board could choose to delay the adjustment for 2010 rates and hold that issue for the 2010 rate case. If the Board disallows the adjustment for 2010 rates in this case, this decision would mitigate some immediate rate impact and acknowledge arguments of Consumer Advocate, ICC and LEG that IPL is in fact responsible in some fashion for the circumstances that have allowed these higher rates. If IPL so chooses, it could begin recovering these costs with relatively little lag (realistically about 3 months) in interim rates in IPL's next anticipated rate case.[24]

2008 True-Up Adjustment

Staff note: IPL's and others' references to a "2010 True-Up" mean the true-up for 2008 charges, as it appears two calendar years later in ITC-M 2010 rates.

IPL Initial

Initial Brief: pp. 32-34

Schedules B-25 and D-8 represent recovery of the 2008 true-up adjustment, included in ITC-M's 2010 revenue requirement.[25] It will be charged in 2010 and is known and measurable. (Tr. 371) Page 1 shows the four-year annual amortization of IPL Iowa electric $46.4 million as $11.6 million – the "Amortization Proposal." Page 2 shows IPL's preferred alternative, which results in no impact in this case, to offset the true-up costs with a portion of the SPU-07-11 ATA regulatory liability account.

Initial Brief: pp. 47-48, 50

The Board should not adopt Mr. Fuhrman's suggestion to exclude the unrecovered balance of the true-up from rate base and defer decision to the next rate case. Mr. Fuhrman's concern of excess carrying costs was addressed in IPL rebuttal and Mr. Fuhrman agreed in his rebuttal. (Tr. 920) The revised rate base adjustment allows IPL the opportunity to earn a reasonable carrying cost on the average balance, and it is fair and reasonable for the Board to allow it and make that decision in this case. (Tr. 462) Deferral of this issue is inefficient and would increase time and costs in litigating the issue more than once.

[24] IPL anticipates filing a rate case in March 2010. Interim rates would likely be effective in late-March or early-April 2010.

[25] IPL states that contrary to ICC witness Brubaker's contention (Tr. 1296), the true up aspect of ITC-M's rates was noted in the Board's September 20, 2007 Order, pp. 21, 32, 43, and 53.

IPL's preferred alternative, to fully offset the true up using the ATA regulatory liability account, would avoid the rate base issue altogether.

ICC's proposal would include the entire $50 million 2008 under-billing in final rates as compared to IPL's proposal to amortize it. (Tr. 1294, 465)

Consumer Advocate Initial

Initial Brief: pp. 9-10

The true up for 2008 actual costs should be capped. The cap should be the SPU-07-11 IPL estimate ($104.41 million), less 2008 test year actual charges from ITC-M ($91.64 million), amortized over four years. The Iowa electric portion, amortized over four years, is a $3 million adjustment. (Tr. 869-871; Exhibit CEF-1, Revised Schedule B, p. 1, column A)

OCA opposes inclusion in rate base that would allow IPL to earn a return on money it has yet to pay. The issue should be deferred to IPL's 2010 rate case. (Tr. 873-874)

OCA opposes use of the regulatory liability account to offset the true up. This would deny customers, in later years, the benefit IPL promised as part of the ATA. (Tr. 987-989)

ICC Initial

Staff Note: ICC proposes a full 2008 true up as the only ITC-M transmission adjustment to the 2008 test year. This unique argument was previously addressed in other sections.

LEG Initial

Staff note: In its reply, LEG reforms its position for the accelerated return of the ATA regulatory liability refunds and now ties it to IPL's proposal to offset the 2008 true-up adjustment. Therefore, related LEG arguments are presented in this section.[26]

Initial Brief: p. 11-13

IPL proposed a post-2009 refund plan proposing to accelerate the customer refunds from the SPU-07-11 ATA to offset the ITC-M true up for 2010. The Board rejected the plan without prejudice, but consolidated the post-2009 refund plan proposal with this docket.

[26] Prehearing and initial brief LEG arguments to utilize the EAC for accelerated refunds are no longer applicable and are not discussed in this memo.

LEG agrees that refunds should be accelerated and agrees with IPL's rationale. Accelerated refunds better meet the goals of benefitting customers promptly, avoiding erratic rate changes, and implementing refunds without unnecessary administrative burden than the original SPU-07-11 refund schedule. (Tr. 1361, 1379-1380). Accelerating the refund has the additional advantage of increasing value to customers because of the relatively low discount rate – four percent – used in SPU-07-11 for the eight-year period. Even in this economy, customers should expect to earn a return on refund amounts higher than four percent. (Tr. 1380, 1390)

Ag Processing Initial

Initial Brief: p. 9

LEG supports accelerated refunds. IPL's preferred rate treatment alternative is incompatible with accelerated refunds. AGP supports the LEG position.[27]

ICC Reply

Reply Brief: pp. 4-5

ICC disagrees with IPL and LEG with respect to the amortization proposal because those costs are already reflected in the proposed increase to 2009 rates and should be reflected as an adjustment to the test year.

LEG Reply

Reply Brief: pp. 9-11

The customer refunds to which IPL committed in SPU-07-11 should be accelerated. LEG is aligned in joining IPL to recommend that customer refunds be accelerated.[28] LEG is willing to accept IPL's proposal to offset the 2008 true-up costs with a portion of the regulatory liability account provided that the balance of the refunds is flowed through the EAC over a 12-month period commencing at the conclusion of this docket.

[27] Staff note: Ag Processing appeared concerned that if the issues were separable, use of the ATA regulatory liability account for the 2008 true up would make it unavailable for a separate accelerated refund. Ag Processing did not file a reply brief to clarify whether it supports the LEG reply position.

[28] LEG cites witness Latham's explanation of LEG alignment on having dollars today to stay in business and questioning why they should wait eight years [for the refunds] when their cost of money may triple the four percent [used in calculating ATA refund amounts]. (Tr. 1456). LEG also cites LEG Br. 11-13; IPL Br. 4, 33, 108; and Tr. 134-135, 238-240, 274-277, 1361, 1379-1380, 1389-1390.

Only OCA objects to accelerating refunds because it would mean customers in later years would not receive the benefit of the eight-year refund. (Tr. 987-989) However, at hearing OCA witness Furhman's reply regarding customer impact that "if you look strictly at a present value basis, the customers might prefer to get their money out early."[29] (Tr. 987-988)

Accelerating the refunds benefits customers in an economy that has dramatically changed since the SPU was concluded in September 2007. Accelerated refunds would benefit customers as a partial mitigation of the enormous increase proposed by IPL, by increasing value [present value] to the customers as alluded to by Mr. Fuhrman, and by better avoiding erratic rate changes and minimizing administrative burden versus the eight-year refund schedule.

Staff Analysis

With respect to the true up, embedded issues are: whether the true up should be recovered at all; if recovered, whether a four-year amortization is used for recovery; if amortized, whether the unrecovered balance gets rate base treatment; and whether or not to use IPL's "preferred" alternative to amortization – to fully offset the true-up by depleting most of the ATA regulatory liability account.

Whether the true up is an allowable adjustment is a similar question as the 2010 transmission costs adjustment and staff believes the same options apply.

If the true up is allowed as a 2010 rate adjustment in this case, all parties suggest the amount be amortized.[30] The large true up for 2008 exists because historic (2006 basis) IPL 2007 rates were used in 2008 for ITC-M. The cost impacts are exacerbated because ITC-M also uses a forward looking rate. It is likely a one-time, but very large issue. If recovery is approved, staff recommends amortization over four years.

If amortized, IPL states it should be allowed to earn a reasonable return on the unrecovered balance through rate base. Consumer Advocate recommends deferring this issue until the 2010 rate case. (Tr. 989)

Last, IPL's preferred proposal to offset the true up with the refunds was accepted by LEG in its Reply Brief, with the condition that the balance of the refunds would also be returned to customers within one year of conclusion of this docket. Consumer Advocate acknowledges benefits to some customers (Tr. 987), but maintains the ATA was intended to provide eight-year benefits and expresses concern about future years if the funds are depleted. The issue is likely split by

[29] OCA Witness Fuhrman continued "***Some*** of them do, based on evidence that's been presented in this case." Emphasis added. (Tr. 987).

[30] All parties suggest that the true up be amortized except ICC, who wants only the full 2008 true-up cost as an adjustment to the 2008 test year.

customer class and the Board may not want to impose early depletion of residential refunds without careful consideration of the purpose for which they were established.

The Board should consider accelerated refunds by customer class. However, staff cannot segregate refunds by customer class and develop a plan to implement it based on the record in this case. The Board could direct IPL to file such a plan in its next case.

Finally, it seems difficult to imagine that Joint Applicants in SPU-07-11 had no concept of the increase (more than $50 million true-up before applying interest) in ITC-M costs that would actually be spent in the first year following the transmission sale. Applicants should have been aware and should have more fully developed the record in that case including developing the benefits for such increased investments in that record. As it is, staff believes the issue is best left to the Board's discretion for requested adjustments that can be deferred to mitigate the impact or to the management efficiency issue.

ITC Midwest transmission cost adjustments comprise the majority of IPL's requested increase and non ITC Midwest transmission cost adjustments are uncontested. Positions on ITC Midwest cost adjustments are summarized in the following table:

Proposed Transmission Adjustments for ITC-Midwest Charges:

IPL – Iowa Jurisdictional ($ millions)

	IPL		**OCA**		**ICC**	**LEG**
2009	$56.6 Note 4		$1.003		0	Note 3
2010	$17.5		$4.22		0	Note 3
2008 True-Up (Note 1)	$46.4	$11.5 plus rate base treatment 4-yr	$12.0	$3.0 4-yr	Note 2	Note 3

Notes:

(1) Separate entries are IPL-Iowa TOTAL and 4-year annual adjustments. The IPL 4-year request includes rate base treatment based on a $17.4 million annual average. Staff estimates the associated IPL revenue requirement at $11.5 million plus $2.5 million in average carrying costs, or approximately $14 million in total revenue requirement adjustment sfor 4 years.

(2) ICC's position is that a 2009 or 2010 adjustment is an overcollection as it represents more than one year of transmission expense in a single test year. ICC recommends only recovery of the full 2008 true-up as an adjustment to test year.

(3) LEG focuses on opposing the pass through of costs through a transmission rider and early return of ATA regulatory liability account refunds as an offset to the true up, with the remaining balance refunded within one year.

(4) IPL proposes a total $58.4 million adjustment, of which approximately $56.6 million is related to ITC Midwest.

Transmission Cost Rider

IPL Initial

Initial Brief: pp. 108-122

IPL has proposed an automatic adjustment proposal for transmission-related costs, including ITC Midwest costs. IPL's proposed automatic adjustment clause is similar to the cost recovery methodology used for energy efficiency costs. (Tr. 230) IPL had filed an application with the Board proposing an automatic adjustment clause for costs associated with transmission service provided to IPL by ITC Midwest. The Board rejected the proposal and indicated that such a request was best presented in a rate case

IPL believes an automatic adjustment clause will help minimize the number of rate cases that are needed in order to address transmission expenses, principally, ITC-M's transmission charges, and thereby avoid the administrative burden that affects all interested parties. IPL's proposal fits the basic requirements of an automatic adjustment clause pursuant to Iowa Code § 476.6(8) and 199 IAC 20.9(1). (Tr. 231)

Specifically, the transmission rider will recover expenses associated with the following Midwest ISO Schedules:

Schedule 1 Scheduling, System Control, and Dispatch Service;
Schedule 2 Reactive Supply and Voltage Control;
Schedule 9 Network Integration Transmission Service;
Schedule 10 MISO ISO Cost adder;
Schedule 11 Wholesale Distribution Service;
Schedule 23 Recovery of Schedule 10 and Schedule 17 Costs from Certain GFAs; and
Schedule 26 Network Upgrade Charge from Transmission Expansion.

These expenses are based upon the Alliant Energy West's control area network service at the ALTW.ALTW pricing node. IPL will calculate only the share of expenses attributable to its Iowa retail load. IPL will know the impact of Schedule 9 prior to August 2009 and will know the impact of the remaining schedules by

January 1, 2010. The Schedule 9 charges are the predominate share of costs that would be subject to the transmission rider. (Tr. 766)

IPL will develop cost recovery factors for each class of customer, based on expected costs and sales volumes. Under IPL's proposal, these factors remain in effect for one year and collections are reconciled against actual costs for an annual period. (Tr. 230) The automatic adjustment clause for transmission costs will be reflected on customers' bills as a separate line item similar to IPL's Energy Adjustment Clause mechanism. IPL will compute a separate charge for each of the customer classes. The transmission rider will indicate a charge per kWh applicable to the all kWh usage for the applicable billing cycle for the residential, general service, and lighting customer classes. The transmission rider will indicate a charge per kW applicable to the billing demand for the applicable billing cycle for the Large General Service, Bulk Power, and Standby customer classes. (Tr. 764)

The annual transmission expense will be allocated to the customer classes on an average and excess allocation methodology. This allocation methodology is consistent with how transmission expense has historically been reflected in base rates and by allocating on this methodology there is no shift in transmission cost responsibility between the customer classes.

The factors in the automatic adjustment clause for transmission costs will be revised annually similar to the Energy Efficiency Cost Recovery factors. New factors will become effective January 1st each year going forward, and will remain in effect for the calendar year. IPL will file annually in November of each year for the factors that will become effective on January 1st. (Tr. 765)

IPL's transmission costs, including costs from ITC Midwest, are expected to vary widely over the next several years. For instance, IPL's expected annual costs, from ITC Midwest for network integration transmission service (Schedule 9), are:

2008: $ 77,391,000
2009: $137,561,000
2010: $206,012,000
2011: $170,000,000

Traditional ratemaking practices are not well suited to address cost changes of this magnitude, especially when IPL has no direct control over these costs. (Tr. 231) An automatic adjustment clause will allow for a one-to-one matching of costs incurred and costs recovered from customers. The costs will likely be volatile from year-to-year and the proposed mechanism will insure that neither the company nor the customer pays more or less than the actual costs incurred. (Tr. 232)

Board Criteria under 199 IAC 20.9

Intervenor witnesses Brubaker and Latham urge that IPL's proposal be rejected because it does not meet all of the criteria in the Board's rules for an Automatic Adjustment Clause. However, the Board has the authority to approve an automatic adjustment clause for these costs pursuant to Iowa Code § 476.6(8) Consumer Advocate witness Fuhrman also opined that Iowa Code § 476.6(8) provides the Board with wide latitude to approve such automatic adjustment mechanisms as it deems appropriate. He also noted that the Board has clearly utilized this latitude in establishing the energy adjustment clause, the purchased gas adjustment clause, the energy efficiency cost recovery mechanism, and the Cooper Nuclear Tracker. (Tr. 906-907) The issue surrounding an automatic adjustment clause for transmission costs is more a question of regulatory and pricing policy than it is a question of whether the criteria in the Board's rules can be interpreted as a perfect match for these costs. (Tr. 255)

IPL believes that these costs meet the Board's criteria for an automatic adjustment clause (Iowa Code § 476.6(8) and 199 IAC 20.9(1)) allows the Board to approve a rate-regulated utility's request to implement a sliding scale or an automatic adjustment of electric utility energy rates for costs which meet five criteria. The five criteria for those costs are: 1) Incurred in the supplying of energy; 2) Beyond direct control of management; 3) Subject to sudden important change in level; 4) An important factor in determining the total cost to serve; and 5) Readily, precisely, and continuously segregated in the accounts of the utility.

IPL's proposal meets each of these criteria, as outlined below. (Tr. 232-233)

Incurred in the Supplying of Energy - IPL is now invoiced monthly by the MISO for costs that ITC Midwest incurs to provide IPL transmission service. The costs billed by MISO are required in the supply of energy to IPL's customers from IPL's generation sources. (Tr. 233)

Intervenor witness Brubaker rejects IPL's claim that ITC Midwest costs are required in the supply of energy but fails to explain how customers would get access to energy without the high voltage transmission lines provided by ITC Midwest. Mr. Brubaker then suggests that transmission charges would then be no different than distribution or generation costs regulated by the Board. The ITC Midwest rates are directly regulated by the FERC. The components of IPL's rates that are based upon its distribution and generation costs are directly regulated by the Board. (Tr. 256)

Beyond Direct Control of Management - ITC Midwest costs are part of the FERC-approved MISO tariff. IPL does not control the FERC approved MISO formula rates nor the underlying costs reflected in those rates. Not only does IPL have no direct control over these costs, the costs are also difficult for IPL to indirectly manage. (Tr. 235)

Both Dr. Latham and Mr. Brubaker mentioned IPL's ability to influence these costs. There is a clear difference between controlling costs and influencing costs. IPL cannot control those costs, as they are the result of business decisions made by IPL's independent transmission provider, resulting in rates approved by the FERC. (Tr. 258) IPL is willing to make a routine (annual) filing to keep the Board apprised on activities IPL has taken to influence transmission costs. This can provide some level of indirect Board oversight that IPL is taking appropriate steps to positively influence both ITC Midwest and the FERC when it comes to the cost-benefit trade-off. (Tr. 259)

Subject to Sudden and Important Change in Level - The nominal change in costs between 2008 and 2010 is projected to be as high as $70 million. In the foreseeable future, IPL expects both cost increases and cost decreases from the MISO/ITC Midwest charges, due in part to the reconciliation process that ITC Midwest will utilize as part of its formula rate process. (Tr. 233-234)

Important Factor in Determining the Total Cost to Serve - Transmission is an important functional component required to deliver energy to IPL's customers. IPL's total costs from ITC Midwest in 2010 are expected to be about $200 million. This represents roughly 15 percent of IPL's overall revenue requirement. (Tr. 234)

Readily, Precisely, and Continuously Segregated in the Accounts of the Utility - Since the end of 2007, IPL has been receiving MISO invoices related to providing transmission service to IPL for the benefit of all of IPL's electric customers. IPL utilizes separate accounting strings so that the MISO transmission invoices related to ITC Midwest costs can be separately tracked from other MISO-related charges. This segmentation of costs allows for IPL to readily ascertain the actual monthly transmission expenses related to ITC Midwest transmission costs. (Dr. Latham's claim that transmission costs are not clearly segregated in the accounts of the utility is erroneous. Similar to fuel costs, transmission costs are accounted for separately by FERC account and are easily identifiable. (Tr. 257)

Dr. Latham's assertion (Tr. 1369) that transmission service bills from other suppliers are paid by AECS according to Service Agreements is incorrect. IPL Exhibit DV-2, Confidential Schedule A contains a sample of the most current invoices from the non-MISO transmission service providers. It is easy to verify and monitor these charges directly attributable to IPL and paid by IPL since the costs are separately identifiable and would all be charged to FERC Account 565. (Tr. 803-804)

Dr. Latham alleges that the MISO bills do not contain separate charges for IPL and its utility affiliate Wisconsin Power and Light Company (WPL) and include wholesale transactions and certain energy transactions. He also claims that monitoring would be difficult to ensure there is no double collection of costs between IPL's existing energy adjustment clause and the proposed transmission

adjustment clause. (Tr. 1370) As IPL witness Vognsen explained, these claims have no merit. IPL Exhibit DV-2, Confidential Schedule B contains a printout of the electronic files MISO provides with the invoice. This detailed electronic spreadsheet MISO provides breaks out MISO transmission charges between ALTW (IPL) and ALTE (WPL) as well as by schedule. (Tr. 804) Also during the hearing, Dr. Latham demonstrated the ease of tracking the information provided in MISO's invoices. (Tr. 1420-1428) Dr. Latham's demonstration undercuts his concerns that the Board staff or the Consumer Advocate would be ill-equipped to monitor IPL's transmission rider. (Tr. 1458-1459, 1462)

MISO sends separate invoices for transmission charges versus energy charges so there is no co-mingling of charges between transmission and energy as Dr. Latham contends. The transmission invoices are received monthly; whereas the energy invoices are received weekly. As depicted in Exhibit DV-2, Confidential Schedule B, each of the applicable MISO transmission schedules is separately identifiable and itemized. Similar to the non-MISO invoices, it would be very simple to monitor and verify these costs. All of these IPL charges would be booked to FERC Account 565. (Tr. 804-805)

Lack of an automatic adjustment clause may put IPL in a position where it can never fully recover its costs, if ITC Midwest's rates continue to increase. This occurs because the rates approved by FERC are placed into effect January 1 of each year. Under the traditional ratemaking structure in Iowa, IPL (assuming a calendar year test period) cannot place interim rates into effect until late March. As a result, there is a lag between the change in ITC-M transmission rates and IPL's ability to recover those increases in rates. (Tr. 236) An annual rate case to recover increases in transmission costs is not a realistic long-term solution.

Consumer Advocate Initial

Initial Brief: p. 12

IPL witness Madsen proposed that IPL be allowed to implement an automatic adjustment clause mechanism for ITC transmission costs. Consumer Advocate witness Fuhrman did not object to such an adjustment clause because the traditional test to determine whether a cost should be recoverable through an automatic adjustment clause is satisfied. As a result of the transmission asset sale to ITC Midwest, transmission expenses are no longer significantly within IPL's control. Transmission costs are significant and are subject to significant fluctuations from year to year. (Tr. 883-884)

Consumer Advocate shares some of the concerns raised by LEG, but concluded that an automatic clause is necessary in this case, at least until transmission rates become more stable. Without an automatic adjustment clause for transmission costs, a significant reduction in ITC Midwest rates from the amount included in IPL's base rates would result in a windfall to IPL and its shareholders

at the expense of IPL retail customers as there would be no mechanism in place to pass savings to retail customers resulting from low ITC Midwest rates.

The implementation of an automatic adjustment clause does not release IPL from honoring its hold harmless commitment to its customers from the transmission sale docket.

ICC Initial

Initial Brief: pp. 58-63

Under IPL's proposal, IPL would automatically pass to its retail customers 100 percent of the portion of ITC Midwest charges that are allocable to those customers. Any true-ups would also be charged to retail customers either as accredit or as an additional charge. IPL claims that the proposed clause is similar to the methodology used for energy efficiency costs and meets the criteria set forth in Iowa Code 476.6(8) and 199 Iowa Admin. Code 20.9(1) IPL is mistaken. First the proposal is not sufficiently similar to energy adjustment clause to adopt for transmission costs. The energy efficiency recovery mechanism is based on stakeholder input, Board review of the plan, and Board approval of recovery cost levels. This proposal lacks such Board oversight and protection. IPL's proposal greatly reduces Board oversight and would automatically shift risk from IPL-ITC Midwest transaction to retail customers who did not support the transaction and who have much less influence over the process and cost level than does IPL.

IPL states that the proposal will benefit all parties as it will help minimize number of rate cases that are needed to address ITC Midwest charges, and thereby avoid administrative burden on all parties. To the contrary, IPL proposal could harm the interested parties as Transmission costs would be passed through to retail customers without Board oversight. Despite its shortcomings, rate case still remains the best course for the Board, consumer Advocate, and customers to participate in the oversight and control of IPL costs.

IPL neglects the fact that future cost decreases may offset increases in transmission costs obviating the need of an automatic adjustment. Cost decreases may occur for many reasons: 1) a reduction in rate base as a result of the build-up of accumulated depreciation and deferred income taxes; 2) additional revenues from growth; 3) improved operation efficiencies by means such as automation; and 4) work force reduction.

IPL's proposal also fails under the five criteria outlined under IAC 20(9). Even if IPL proposal satisfies the criteria, there is no mandate that the Board must approve the proposal. Under the first criteria, the charges must be incurred in

the supplying of energy. According to IPL's logic, the same treatment could be allocated to other costs including distribution costs, generation costs, and the like, all of which are required in the supply of energy. Transmission costs are not the kind of costs envisioned by the first criterion. IPL believes the proposal meets the second criterion because IPL does not control the FERC approved formula rates nor the underlying costs reflected in those rates. Although this may be true, but IPL can influence these costs by managing its relationship with ITC Midwest and participating at FERC proceedings. To the extent that IPL is not doing this and trying to manage other transmission costs then IPL should not be given a license to pass those expenses. The transmission expense does not meet the second criterion. The third criterion is that the charge be subject to sudden important change in level. It is not clear that transmission expense changes are sudden. While the 2008 ITC Midwest formula rates are different from the initial rates, this is more likely a solitary event. The future changes and true-ups are likely to be smaller as partied gain experience in actual operations. While IPL complains of its relationship with ITC Midwest, IPL will have to deal with this problem as it seeks to manage its costs more effectively. Neither the Board nor IPL's customers can do this as effectively as IPL can. For these reasons, the Board should conclude that the third criterion is not satisfied. The final two criterion that this charge should be an important factor in determining the cost to serve and that it is readily, precisely, and continuously segregated in the accounts of the utility are the only two criteria of the five that are undisputed. These two criteria themselves are not sufficient to justify adopting a new automatic adjustment clause for transmission expense.

LEG Initial

Initial Brief: pp. 6-11

LEG joins ICC in vigorously opposing IPL's proposal. Under present circumstances and for the foreseeable future, transmission charges should be recovered by IPL in a rate case.

In a recent Black Hills case, Docket No. RPU-08-3, on May 7, 2009, the Board issued an order rejecting a Capital Addition Tracker for recovery of the costs of non-revenue-producing system integrity capital costs. The evidentiary record in this docket and the precedent set by this recent decision compel an identical analysis and conclusion. Historically automatic adjustment clauses have been allowed on a limited basis and have been for costs that are beyond the control of management and are subject to change levels. IPL's proposal does not meet the criteria normally required for an automatic adjustment. The evidence shows that transmission costs recovered through the automatic adjustment clause can be projected fairly accurately, will not fluctuate dramatically from year to year, IPL has significant control of these costs, and transmission costs are not an important factor in determining total cost to serve. (Tr. 1292-1293, 1372-1374, 1385, 1404-1405) The automatic adjustment would allow IPL to increase rates

for electric service and increase revenues outside of a rate case without any risk of non-recovery and without matching costs with reduced expenses. For the Board to approve this mechanism, it would have to find that there was an extraordinary need for the mechanism or the benefits outweigh the costs. The evidence does not show that the projected expenditures are extraordinary and require extraordinary treatment. The annual Board review of the true-up would either be limited, or it could turn into a miniature rate case without customer notice and other procedural protection. The expectation of another IPL rate case, while the automatic adjustment is in place, removes another potential benefit of the automatic mechanism that could have been provided to ratepayers. Even if the Board approves IPL's proposal, it is unreasonable since it does not include an adjustment of the return on equity for the reduced risk that the adjustment clause provides. (Tr. 184, 233, 1533) Without this adjustment and without an agreement to delay the next rate case filing, IPL's proposal does not provide that outweigh the costs of this deviation from traditional regulation.

Based on this analysis, the evidentiary record in this proceeding, and the recent precedent, the Board should reject IPL's proposal. If the Board ultimately decides to approve IPL's proposal, charges per kW of demand should be cost-based by delivery level. (Tr. 1360) IPL proposes to develop rate for automatic adjustment by reducing the Large General Service base rate demand charges by $2.13/kW/month to remove the estimated demand charges from existing base rates and introducing a estimated $3.92/kW/month adjustment factor for this class. This proposal would result in an immediate increase in rates for many Large General Service customers. (Tr. 1375.) The Large General Service customers are subject to primary service discounts based on delivery voltage level. By implementation of the proposed adjustment clause, Large General Service customers will lose the primary service discount. This problem can be solved by including the discount in the transmission $/kW adjustment as well. IPL witness Vognsen appears to have agreed to this solution during cross-examination at the hearing. (Tr. 813-815)

Ag Processing Initial

Initial Brief: p. 7

AGP supports the testimony of ICC witness Brubaker and LEG witness Latham stating that IPL's proposed automatic adjustment clause for transmission costs should be rejected. Denial of this proposal is consistent with the Board order in Docket No. RPU-98-3. If the Board does decide to approve the proposal, the charges per kW demand should be cost-based by voltage delivery level.

IPL Reply

Initial Brief: pp. 34-37

In its Initial Brief LEG claimed that IPL's proposal is similar to the automatic adjustment clause proposed recently by Black Hills, which the Board rejected. IPL will review each of LEG's arguments.

LEG Brief on Automatic Adjustment Clause	Black Hill's Tracker	IPL's Rider
Historically, automatic adjustment mechanisms have been allowed only on a very limited basis and are typically limited to costs that are beyond the control of management, are subject to sudden changes in level, and are an important factor in determining the total cost to serve.	Black Hill's tracker was based on incremental system integrity capital investments with a carrying charge. Such investments were in the direct control of management, and therefore sudden changes could be managed.	IPL does not control these costs, including the size and the timing of expenditures.
IPL's proposal does not meet the criteria normally required for an automatic adjustment mechanism. The evidence shows that the transmission costs can be projected fairly accurately and will not fluctuate dramatically from year to year, that IPL has a significant degree of control over the amount of the transmission c, and that transmission costs are not an important factor in determining the total cost to serve.	The Black Hill's investments could be projected fairly accurately, investment did not fluctuate dramatically year to year, and Black Hills had significant control over the investment decisions.	IPL outlines how it met each of the five Criteria in its Initial Brief.
The proposal allows IPL to increase rates for electric service and generate increased revenue outside of a rate case without any risk of non-recovery and without matching those costs against reduced expenses.	Black Hills under their proposal would be able to receive incremental revenues and returns above that approved in a rate case.	There is no "incremental return" available to IPL. The Black Hills clause was for ***capital additions***. IPL's proposed rider reflects ***expenses*** and would match expenses and related revenues one-to-one with an annual reconciliation that would include oversight from the Board.
For the Board to approve a mechanism such as the TAC, it would have to find that there was an extraordinary need for the mechanism or the benefits outweighed the cost of this significant deviation from regulatory policy.	The Black Hills CAT projected expenditures were not extraordinary and require extraordinary treatment. IUB considered it prudent regulatory policy to review the projected expenditures.	IPL addresses expense projections in its Initial Brief. Further, it is clear that the costs in question are "extraordinary" in a number of ways: • IPL purchases 100% of its transmission service. • The rates paid by IPL (costs incurred) are regulated by the FERC.
The evidence does not show that the projected expenditures are extraordinary and require extraordinary regulatory treatment.	Black Hills had not had a complete test year of managing the utility. IUB considered it prudent to wait before considering a mechanism that guaranteed revenues. (IUB order RPU-08-3, Page 23).	The costs that IPL will incur for transmission service are significant and vary significantly.

LEG Brief on Automatic Adjustment Clause	Black Hill's Tracker	IPL's Rider
The proposal would have a true-up each year where the Board could review the costs recovered; however, this review would either be limited, or it could turn into a miniature rate case without customer notice and other procedural protections.	The IUB still has a responsibility to review capital expenditures and this review would be limited under Black Hill's proposal.	The process would be analogous to the annual Energy Efficiency Cost Recovery filing. Further, it is the FERC that determines the rates IPL must pay in this scenario, not the Board. The Board can clearly control the administration it wishes to use for auditing purposes. Other reconciliation processes currently in effect in Iowa have not turned into "mini rate cases."
The expectation that IPL will file a rate case while the proposed adjustment is in effect removes another potential benefit that could have been provided to ratepayers. Customers would be faced with the yearly increase in rates from the adjustment and the additional rate case expenses from the next rate case. The benefits of the proposal do not outweigh the costs.	The cost-of-service study shows that there may be more appropriate, and less drastic, means to achieve Black Hills Energy's objective of earning its authorized rate of return, such as an increase in customer charges.	Annual rate cases to recover transmission expenses are not a realistic solution. It is clear in this case that lack of an automatic adjustment clause will prevent IPL from earning its authorized returns, all other things equal. The clause would not enhance IPL returns compared to its authorized return. The rate case approach causes both regulatory lag and significant costs of administration for all parties.
Even if the Board were to determine that the proposal is justified, it is not reasonable since it does not include an adjustment of the return on equity for the reduced risk that the automatic adjustment provides. The lack of a reduced return on equity and the statements of IPL witnesses that another rate case will be filed next year weigh against approval of IPL proposal	Black Hill's proposal allowed the recovery of the system integrity investments through depreciation and a recovery on the system integrity investments through a return on equity of 10.1 percent and an overall rate of return of 8.71 percent, the same as agreed to for the revenue issues. The rider will use the same return on equity agreed to for the revenue issues. Again, no adjustment in the return has been made to reflect the reduced risk associated with guaranteed recovery each year outside of a general rate case.	The IPL transmission rider does not include a return component since it is only for recovery of expenses. IPL outlines the transmission expenses in its Initial Brief. The Black Hills proposal was a capital additions tracker. IPL's proposal is an expense tracker. Further, IPL's risk has increased without a clause, (versus comparable vertically integrated utilities) since it cannot directly control the timing or level of costs incurred

LEG Reply

Reply Brief: pp. 2-9

IPL witness Madsen during cross-examination revealed a major difference between the energy efficiency rider and the current proposal. The proposed rider is missing an important feature, namely, the Board's ability to review the reasonableness and prudence of the costs to be recovered by the utility. Mr. Madsen agreed that inclusion of this would feature would provide a powerful incentive for IPL to manage its costs. LEG witness Latham also expressed concern about the ability of Board staff to give costs flowed through transmission

rider the same degree of scrutiny given to costs recovered through a rate case. IPL states that approval of a transmission rider will help minimize number of rate cases. According to IPL witness Aller, IPL will be filing a rate case in March 2010. It can be reasonable anticipated that another rate case will be filed in 2012 or 2011. Witness Aller was unwilling to make any rate-freeze commitments.

LEG clearly demonstrated in its Initial Brief that there is ample evidence in the record for the conclusion that IPL has a significant degree of control over transmission cost and fails to satisfy the criterion that "the cost are beyond the control of the management."

IPL also did not make a showing that the costs are subject to sudden changes in level. This deficiency of proof is also evident in the case presented by the Consumer Advocate.

IPL states that total ITC Midwest costs for 2010 are expected to amount roughly 15 percent of IPL's overall revenue requirement. The LEG begs to differ. IPL witness Hampsher's schedule show that 2008 transmission charges allocated to Iowa customers to about seven percent which increase to ten percent in 2009. IPL is inflating the 2010 revenue requirement impact of the transmission charges for 2010. If transmission costs are an important factor in determining the total costs to serve, the same can be said for distribution costs. Transmission costs are far from unique in this respect.

IPL's argues that Board approval will not remove IPL's incentive to manage its transmission costs. IPL has confused a legal obligation with an incentive. IPL has an incentive to perform its legal obligations. This does not mean that regulatory policy should not put into place incentives in addition to the bare minimum represented by the legal obligation IPL shares with other Iowa utilities.

Consumer Advocate stated in its Initial Brief that it seems that IPL has been satisfied with simply passing on higher fuel costs to its customers through its automatic adjustment clause rather than looking for ways to reduce costs. The same could, and should be said about the IPL's proposed transmission rider.

Consumer Advocate's Initial Brief appears to suggest a new condition that until transmission rates become more stable, a transmission rider should be in effect. This new condition does not allay LEG's concerns. A better approach is to defer implementation until transmission costs stabilize. IPL witness Madsen agrees that transmission costs are volatile now as it is going through a transition period. At the very least, any decision regarding this issue should be deferred to the IPL rate case filed in March 2010.

ICC Reply

Reply Brief: 21-23

ICC stands on its Initial Brief and concurs with the arguments and analysis of LEG. ICC adds that IPL's attempt to distinguish distribution and generation services from ITC Midwest costs because the former are Board regulated and latter are FERC regulated is a distinction without a difference. Regulation of these costs does not tell us why only one should be characterized as incurred in the supplying of energy but not the other.

The Board should treat IPL statement that "it will ultimately have to justify [the ITC Midwest costs] to its customers, so therefore IPL has considerable incentive to manage these [cost]" with skepticism. With the proposed transmission rider, IPL will be able to collect costs without any Board review or oversight.

Staff Analysis

Historically, return on transmission assets and transmission O&M expenses have been recovered through IPL's base demand and energy charges included in base rates. IPL is proposing to recover all transmission costs through a separate rider as part of final rates. IPL did not propose a rider for interim rates.

Consumer Advocate supports establishment and the concept of an automatic adjustment clause but questions some of the costs that are proposed to flow through it.

ICC, AGP and LEG oppose IPL's proposal as they believe it does not meet the automatic adjustment clause criteria outlined in Board rules.

Iowa Code 476.6(8) states that:

> Automatic adjustments permitted. This chapter does not prohibit a public utility from making provision for the automatic adjustment of rates and charges for public utility service provided that a schedule showing the automatic adjustment of rates and charges is first filed with the board.

Iowa Administrative Code 199 20.9 establishes an electric energy sliding scale or automatic adjustment and states that:

> A rate-regulated utility's sliding scale or automatic adjustment of the unit charge for electric energy shall be an energy clause.
>
> **20.9(1)** *Applicability.* A rate-regulated utility's sliding scale or automatic adjustment of electric utility energy rates shall recover from consumers only those costs which:
>
> Are incurred in supplying energy;
> Are beyond direct control of management;

Are subject to sudden important change in level;
Are an important factor in determining the total cost to serve; and
Are readily, precisely, and continuously segregated in the accounts of the utility.

20.9(2) *f*. A rate-regulated utility which proposes a new sliding scale or automatic adjustment clause of electric utility energy rates shall conform such clause with the rules.

It appears that Iowa law allows establishment of automatic adjustments of rates and charges as long as the charges are first filed with the Board. Staff believes that current transmission costs for IPL are still going through a transition period. IPL in its brief agreed that it is willing to make a routine (annual) filing to keep the Board apprised on activities it has taken to influence transmission costs. IPL believes and staff agrees that this can provide some level of indirect Board oversight that IPL is taking appropriate steps to positively influence both ITC Midwest and the FERC when it comes to managing its transmission costs.

Staff agrees with the basic concept of IPL's proposed transmission rider. Consumer Advocate supports the transmission rider concept. Consumer Advocate questions some of the costs that will be included in the rider. Several intervenors opposed recovery of transmission costs through an automatic adjustment rider. Staff believes that it would be reasonable to deny the proposal in this case and require the parties to file more specific proposals in the 2010 IPL rate case. This would give an opportunity and allow time to all parties, including the Board, prior to the case being filed, to discuss in an informal process how the rider should be structured, the Board's regulatory oversight, and other potential issues that could not be discussed in a formal setting.

Cost of Capital Issues

There are two main decisions that the Board needs to make regarding the cost of capital: 1) setting the appropriate return on equity (ROE) and 2) determining the appropriate capital structure. To make these decisions, it will be necessary to consider and ultimately decide on many of the sub-issues presented by the various parties. There are three parties that present evidence on the cost of capital issues: IPL, Consumer Advocate, and ICC. However, ICC has reviewed what IPL has proposed for the capital structure and agrees that what IPL has proposed is reasonable when compared to the capitalization of IPL's proxy group. Therefore, ICC focuses on what the appropriate ROE should be in this case.

Cost of Equity

Introduction

As mentioned in the pre-hearing memo, determining the appropriate rate of return on common equity to include in a utility's capital structure can be one of the most difficult and controversial issues in any rate case. It is almost always a large dollar issue. This holds true for this case.

As mentioned above, there are three witnesses that provided ROE testimony. All three agree to use the discounted cash flow (DCF) model and the capital asset pricing model (CAPM). Only IPL and ICC use the risk premium method. Finally, IPL initially used the comparable earnings model but then ignored the results because they were unreliably high. Although this model does not impact IPL's recommendation, both Consumer Advocate and ICC argued against the model in its testimony and ICC continued to argue against in its brief. IPL, in its reply brief, expressed confusion as to why the comparable earnings model continues to be an issue. IPL is not suggesting that this model be considered at all; therefore, staff is not including it as an issue in this memo. Regarding the other models, there is virtually little that is agreed to.

IPL witness Hanley initially recommended an 11.8 percent ROE. However, since the filing of his direct testimony, the market data has changed enough that he adjusted his recommended ROE to 11.2 percent, a 60 basis point drop. Although he updated his overall recommendation, the results of the above mentioned models still reflect December 2008 through early February 2009 data. Mr. Hanley did not include in the record any updated results. Therefore, it is difficult to discuss or use the various ranges of the results from his testimony when they do not support the updated recommendation.

Both Consumer Advocate and ICC recommend a 10 percent ROE. Neither updated their ROE analysis in rebuttal testimony or at hearing. However, due to the timing of their initial filing, July 17, 2009, these parties' data are more recent than IPL's original data. Staff will note that IPL touts its witness as being "the only witness in this proceeding to submit a complete, fair, supportable, and up-to-date approach to the ROE determination in this proceeding." (IPL Initial, p. 96) If Consumer Advocate and ICC also updated their ROE analysis, staff would assume that their recommendation would have been reduced as well. However, staff does not believe that either Consumer Advocate or ICC makes this point in their briefs.

Finally, since much of the evidence presented in testimony and summarized and analyzed by staff within the Pre-hearing memo, dated September 18, 2009, has not changed in briefs, staff has taken much of the analysis from the Pre-hearing memo and included it within this memo and updated it as necessary.

Overview of Positions

A brief summary of contrasting methods and results is shown below.

Witnesses	Methods Used	Results	Recom-mendation
IPL Hanley (1) (Tr. 1480)	Discounted Cash Flow (DCF)	10.66 – 10.76%	11.2% (2)
(Tr. 1480)	Risk Premium (RP)	12.26%	
(Tr. 1480)	Capital Asset Pricing Model (CAPM)	11.33%	
	Update of Gorman's RP	10.86%	
OCA Vitale (Tr. 1746-1747)	DCF	9.7 – 10.8%	10.0%
(Tr. 1747)	CAPM	8.2 – 8.6%	
ICC Gorman (Tr. 1842)	DCF	10.65 – 11.76%	10.0%
(Tr. 1852)	CAPM	8.83 – 8.88%	
(Tr. 1846)	RP	9.84 – 10.17%	
(Tr. 1847)	Board RP	9.0 – 11.0%	
(Tr. 1861)	Multi-stage DCF of Hanley's Data	10.42 – 10.52%	

(1) Mr. Hanley's results do not reflect his adjustment for both business and financial risks; however, his recommendation does.

(2) Mr. Hanley has updated his recommended ROE from 11.8 percent to 11.2 percent; however, he did not provide updates to the results included in the above table.

Therefore, the recommended ROE range is **10 percent to 11.2 percent.**

Legal Guidance[31]: The U.S. Supreme Court, in its 1942 decision in *Hope Natural Gas Company* (320 US 591) (*Hope*), held that "...the return to the equity owner should be commensurate with returns on investments in other enterprises having

[31] This section was taken directly from Post-hearing memo, Docket No. RPU-08-01, pp. 39-40, prepared by Board staff Chancy Bittner.

corresponding risks. The return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain credit and attract capital . . .."

A number of standards of fairness and reasonableness regarding the allowed rate of return flow from the U.S. Supreme Court's judicial decisions: (1) a standard of capital attraction, (2) a standard of comparable earnings, (3) financial integrity, and (4) balancing of consumer and investor interests.

As based especially on the capital attraction approach, the ROE is an economic and financial concept that refers to an expected or required return. It is an opportunity cost that cannot be measured but rather must be **estimated**. Analysts make an educated guess using theories and models that can be somewhat complex and sophisticated. This estimation is **not precise** and involves the exercise of **judgment** by the analyst, and ultimately by the Board.

Support for the notion of Board judgment is also found in the *Hope* case in the end-result doctrine. It is the end result that is important and not the methods used to arrive at the rates. In addition, *Permian Basin* (1968) added, "the 'end-result' of the Commission's orders must be measured as much by the success with which they protect those (broad public) interests as by the effectiveness with which they 'maintain credit . . . and . . . attract capital'."[32]

The generally accepted interpretation of the Court rulings is that no particular method or rate of return is required. Plus, the allowance will vary with economic conditions. Therefore, many models and differing procedures may be used to generate ROE estimates.

Sub-issue: Recommended Return on Equity (ROE)

IPL Initial

Initial Brief: p. 97

Using the Discounted Cash Flow (DCF) model, the Capital Asset Pricing Model (CAPM), and the risk premium method and applying these models to his proposed proxy group, IPL witness Hanley originally proposed a ROE of 11.8 percent. To help mitigate ratepayer impacts from the rate increase, IPL reduced its recommended ROE to 11.4 percent.

Since the time IPL originally filed its testimony, there has been a decline in capital costs. (Tr. 1662) Mr. Hanley suggested that there has been a 60 basis point drop in his estimated ROE and is now recommending **11.2 percent**.

[32] 390 U.S. 747, 20 L. ed. 349-350.

By adding Mr. Hanley's recommended risk premium range of 400 to 500 basis points to the 12-month average A3 public utility bond yield of 6.92 percent, the range would be 10.92 percent to 11.92 percent. This demonstrates that the 11.8 percent recommended ROE and the requested ROE of 11.4 percent fall within this range.

The table below highlights the models used by Mr. Hanley and the results that were produced by those models.

Witness	Methods Used	Results	Proposed ROE
IPL's Hanley	Indicated DCF Return Rate	10.66 – 10.76%	11.2%[33]
	Risk Premium using Utility Proxies	12.26%	
	CAPM using Utility Proxies	11.33%	
	Adjustments Used	***Adders***	
	Business Risk Adjustment for Utility Proxies	0.16% – 0.19%	
	Financial Risk Adjustment for Utility Proxies	0.20%	

Consumer Advocate Initial

Initial Brief: pp. 84, 99-102

Consumer Advocate witness Vitale focuses on his DCF analysis in determining the appropriate ROE for Alliant. Additionally, he uses the CAPM. These two models are first applied to Alliant and then to his proxy group. He determined a ROE of **10 percent** for Alliant, the upper limit since the other utilities generally do not have advance ratemaking principles on new generation, advance approval of emissions plans and budgets, and provisions that are risk reducing. (Tr. 1746-1748)

Witness	Methods Used	Results	Proposed ROE
OCA's Vitale	DCF of Alliant and Utility Proxies	9.7 – 10.8%	10.0%
	CAPM of Alliant and Utility Proxies	8.2 – 8.6%	

[33] The proposed ROE reflects IPL's proposed risk adjustments.

The 10 percent ROE compares favorably to: 1) the 4.1 percent yield on 20-year Treasury bonds for the 12-month period ending May 2009, 2) the 4.2 percent on 20-year Treasury bonds in May 2009, 3) 6.6 percent average yield on A-rated utility bonds for the 12-month period ending in May 2009, and 4) the 9.6 percent market return on Standard & Poor's (S&P) 500 with a beta of 1 compared to Alliant's beta of 0.70. (Tr. 1749-1751)

IPL's growth estimates of 6.4 percent to 6.8 percent are not sustainable and not probable during the next five years during a major recession. (Tr. 1751-1753) Additionally, IPL relied on 5-year projections for all of his models that are unrepresentative and aberrational (Tr. 1765) and relied on a narrow and atypical economic trough in the business cycle. Ibbotson states "the highest returns occur when markets pull out of calamities like the current recession." (OCA Brief, p. 102)

The end result is IPL's ROE estimates are overstated, unreliable, improbable, and unrepresentative. (Tr. 1760-1765)

ICC Initial

Initial Brief: pp. 22, 28-32

IPL recommended ROE of 11.8 percent is excessive. The evidence presented by ICC shows the more appropriate return is 10.0 percent. For example, the Board's risk premium method produces a ROE of 10.0 percent, and other existing authorized return on equities and market evidence also support ICC's proposed 10.0 percent ROE.

ICC uses three variations of the DCF model and the CAPM as part of its analysis to determine the appropriate ROE.

Witness	Methods Used	Results	Proposed ROE
ICC's Gorman	DCF	10.65 – 11.76%	10.0 %
	CAPM	8.83 – 8.88%	
	RP	9.84 – 10.17%	
	Board RP	9.0 – 11.0%	
	Multi-stage DCF of Hanley's Data	10.42 – 10.52%	

ICC evidence shows that a realistic ROE for IPL would be in the range of 9.4 percent to 10.5 percent with a midpoint of 10.0 percent.

Board's decisions that adopted a ROE in other regulatory dockets are consistent with ICC's recommended ROE of 10.0 percent. For instance, the Board approved a 10.1 percent ROE for IPL's proposed SGS 4 plant in Docket No. RPU-08-01, while IPL suggested a 12.55 percent return.

Current market conditions also support ICC witness Gorman's proposed ROE. The credit rating outlook for electric utilities is good. As stated by S&P: [34]

> Against a strong headwind in the credit markets, the regulated U.S. electric utility sector performed well during the first quarter of 2009. Highlights include continued capital market access with robust debt issuance by operating companies in this quarter…Our forecast for the electric sector is for a stable ratings trend for the balance of 2009.

Similar remarks were made by Moody's and Fitch. All three rating agencies believe that the regulated electric utility industry will be able to "weather" the current economic downturn as well as maintain a strong investment grade credit.

The Edison Electric Institute (EEI) compared the performance of the electric utility stock price to the performance of the market. The utility stock prices outperformed the market over the past five years. Apparently the market positively received the commission-authorized returns during that time. EEI provided the following comments in its EEI Q4 2008 Financial Update:

> The relatively stronger performance of utility stocks in both the quarter and the year offers a classic illustration of their traditional role as a defensive investment in times of market stress. In a weakening economy, investors are drawn to the relative stability offered by utilities' dividend yields and more predictable earnings….

More specifically, IPL has an excellent business risk profile and its credit standing is stable. Moody's states, "IP&L's A3 senior unsecured rating is supported by its strong financial metrics, supportive regulatory environment and its parent's conservative business strategy." (Moody's Investors Service Credit Opinion: "Interstate Power and Light," October 1, 2008).

ICC Reply

> Reply Brief: pp. 15-17

In its brief, IPL explains that its ROE reflects an up-to-date result. However, it had relied on outdated data, and, although the market conditions have changed and IPL was aware of it, IPL did not update its models and perform a new study.

[34] Standard & Poor's Rating Direct: "Industry Report Card: U.S. Electric Utility Sector Performed Well in First Quarter of 2009," March 30, 2009.

For example, at hearing IPL witness Hanley admitted that the market risk premium of 7.1 percent has been reduced to 6.5 percent and that the utility bond yields have declined. As provided by ICC at hearing, the A-rated utility bonds yields have gone from 6.52 percent used by Mr. Hanley in his rebuttal testimony to 5.7 percent taken from the Mergent Bond Record (September 2009).

Because Mr. Hanley neglected to update his ROE analysis, IPL's assertion that Mr. Hanley's ROE is up-to-date is wrong.

Staff Analysis

The Board has traditionally focused on the DCF analysis of the parent company and other comparable companies.[35] In addition, the Board in the last decade or so has given significant weight to its risk premium approach. This latter approach has evolved to adding a risk premium of 250 to 450 points to the most current A-rated utility bond rate in the record and to a 12-month average yield on A-rated utility bonds. The Board has not placed much, if any, reliance upon CAPM analysis other than to consider the results along with the rest of the lengthy record. Given that all three parties provide a CAPM analysis, the Board may want to give more consideration to this model than it has given it in the past.

In setting out its basic DCF approach in Docket No. RPU-89-7, Iowa Southern, the Board noted it "is obligated to make its decision in each case based on the specific facts and arguments presented in that case." It also added, "The final determination should not be the result of a rigid and mechanical application of a particular formula."

In this rate case, as in most, each witness uses more than one model to estimate the ROE. Additionally each witness uses a different variation of a specific model. Therefore, there is little agreement between the witnesses on this issue.

Both Consumer Advocate and ICC are recommending a 10.0 percent ROE while IPL's updated recommendation is 11.2 percent. It is important to note that IPL's recommend ROE reflects two adders: one for business risk and the other for financial risk. Therefore, for comparative purposes, the recommended range would then be **10.0 percent to approximately 10.8 percent** before any adders.

Staff notes this section provides more of an overview of the parties' positions; whereas the sub-issues that follow will be where the Board's focus should lie when ultimately deciding what the appropriate ROE should be.

[35] The Board, in the Order of Docket No. RPU-89-7, Iowa Southern, articulated at some length a detailed approach to estimate the cost of common equity using both the DCF and Risk Premium models. Although subsequent decisions have evolved somewhat from this, it is still the most recent major extensive Board review of ROE.

Sub-issue: Proxy Group

IPL Initial

Initial Brief: p. 96

A proxy group of ten electric and combination electric and gas companies was used to determine the appropriate ROE for IPL. (Tr. 1487) Additionally, Alliant, the parent of IPL, was reviewed separately. ICC witness Gorman chose to use the same companies as IPL; however, he included Alliant as part of his proxy group. (Tr. 1829)

Consumer Advocate Initial

Initial Brief: pp. 85-86

Consumer Advocate witness Vitale first reviews the financial data of Alliant, IPL's parent, to determine an appropriate ROE for calculating rates. He claims that the distinction between Alliant and IPL's cost of common equity is difficult to measure. (Tr. 1695) Alliant provides all of IPL's common equity; the regulated businesses (i.e., IPL and WPL) provide Alliant virtually all of its earnings (Ex. SJP-1, Sch. C); and the only way to indirectly invest in IPL is investing in Alliant. (Tr. 1694) Mr. Vitale also reviews financial data of his proxy group. His proxy group consists of four combination companies: SCANA, TECO Energy, DTE Energy, and Wisconsin Electric. (Tr. 1694, 1698) These companies were selected based on factors similar to Alliant. The factors include: being primarily rate-regulated utilities, having both electric and gas operations, having their own generation plants, and depending mainly on coal to generate much of their electricity. (Tr. 1697-1698)

In the past, the Board has mostly relied on the parent company to estimate the ROE along with relying on other combination electric and gas utilities. (Tr. 1696)

It would not be appropriate to rely on IPL witness Hanley's proxy group. Some of the utilities are not similar to Alliant. For example, IPL includes utility companies that are distribution and transmission-only companies and some are electric-only. (Tr. 1696-1697)

No evidence was provided by IPL to show that Mr. Vitale's proxy group was unreasonable. Mr. Vitale's group is most similar to Alliant, the publicly traded company most like IPL.

IPL incorrectly determined its proxy group by focusing on IPL and not Alliant.

ICC Initial

Initial Brief: p. 33

Because IPL is not publicly traded a proxy group of publicly traded companies was needed. ICC witness Gorman used the same proxy group IPL relied upon to estimate IPL's ROE.

Consumer Advocate Reply

Reply Brief: p. 20

The DCF samples that IPL cites in its initial brief are erroneous because they are based on companies that do not resemble Alliant. The proxy group includes electric only companies as well as transmission-only and distribution-only companies. Alliant is a combination gas and electric company. (Tr. 1696-1697)

Staff Analysis

Market-based models like DCF and CAPM cannot be applied directly to IPL because IPL's stock is not traded in the open market. Therefore, there is no IPL stock price that can be used to reveal its investors' expectations.[36] They, however, can be applied to comparable companies to estimate the return for IPL as well as to the parent company, Alliant. According to Consumer Advocate witness Vitale, the distinction between IPL's and its parent's ROE is difficult to measure since Alliant provides all of IPL's common equity. He also explains that the Board has relied on using the ROE determined for the parent company as the cost of common equity for the subsidiary. Staff would agree that the Board uses the parent's ROE as one estimate for the utility's ROE and also considers other proxy group's estimates.

The Board has used proxy groups that consist of combination gas and electric companies and also proxy groups made up of either all electric or all gas depending on the type of utility requesting a rate increase. In this case, all three parties review Alliant's financial data; however ICC includes Alliant as part of the proxy group and does not review its results separately. IPL acknowledged this.

Also, IPL witness Hanley uses both electric only and combination electric and gas companies in his sample group, which includes a total of ten companies. ICC witness Gorman agrees with Mr. Hanley and uses the same companies in his analysis. Consumer Advocate argues that Mr. Hanley's proxy group includes companies that are not similar to Alliant because they are either distribution-only or transmission-only companies. Since generation is typically viewed as the most risky piece of the utility business, it could be assumed that these companies

[36] However, the parent company, Alliant, who owns IPL, does have equity stock in the open market.

would produce a lower ROE estimate than compared to a ROE estimate for Alliant, which does own generation.

Consumer Advocate witness Vitale, instead, proposes only reviewing four companies that are similar to Alliant. Although not specifically argued in briefs, in his rebuttal testimony, Mr. Hanley argues that this group is too small to produce meaningful results. He also believes that Mr. Vitale should not focused on finding companies similar to Alliant when the Board is determining the ROE for IPL.

If the Board were to agree with Consumer Advocate that Mr. Hanley's proxy group was inappropriate to use, it would wipe much of the ROE analysis for two parties: Mr. Hanley and Mr. Gorman. The Board would be left with basically Consumer Advocate's analysis, the Board's risk premium method, and arguably the CAPM analysis of all parties since the betas used by the parties are similar (i.e., both Consumer Advocate and IPL use a beta of 0.70 and ICC uses a beta of 0.65). The DCF analysis that Board has placed emphasis on in the past would be very limited. Staff does not see how that would be beneficial to the Board in making a very difficult decision. Additionally, as mentioned above, some of the companies used in Mr. Hanley's proxy group may be considered less risky than Alliant or IPL given that these companies are either a distribution-only company or transmission-only company, functions of a company considered less risky than generation.

Mr. Hanley's has concern about Mr. Vitale's group first for being too small and second for including companies more comparable to Alliant than to IPL. Although Mr. Vitale does only focus on four companies, these companies provide useful information given that they are comparable to Alliant which does own IPL. The majority of Alliant's earnings come from its regulated combination gas and electric utility companies. Additionally, Mr. Hanley obviously thought that Alliant was comparable to IPL enough to use it as proxy on a stand-alone basis. Therefore, staff agrees that Alliant, and the companies comparable to Alliant, are a good proxy for IPL.

Recommendation: The Board should consider all the ROE results produced by each party's proxy group. By rejecting any party's proxy group, it would narrow the amount of data available for consideration in trying to determine the appropriate ROE, which would hurt the decision making process rather than help it.

Sub-issue: Discounted Cash Flow (DCF) Model

IPL Initial Position

Initial Brief: pp. 98-103

Although all three witnesses use at least one form of the DCF model, IPL witness Hanley's DCF methodology is most reliable for the following reasons:

1) Mr. Hanley uses the median cost rate of 10.66 percent and 10.78 percent for his proxy group and Alliant, respectively, instead of an average cost rate that is much higher (i.e., 12.44 percent). (Tr. 1499-1500)

2) Mr. Hanley does not rely on a spot market price when the stock market is volatile but also includes an average dividend yield for December 2008 and January 2009 with his February 6, 2009, spot price. (Tr. 1500)

3) Mr. Hanley reflected only half of growth in his dividend yield estimate. (Tr. 1500-1501)

4) Mr. Hanley relies on an average projected long-term growth rate in EPS from Value Line and Reuters where an excess of 43 percent of the investors are individual investors that are known to use this information. (Tr. 1501-1502)

Criticisms of ICC witness Gorman's DCF Analysis:

Before specifically discussing Mr. Gorman's DCF analysis, IPL criticizes him for comparing IPL's "senior secured credit rating" with the "senior secured credit rating" of the proxy group. IPL explained at hearing that IPL does not have any senior secured debt in its capital structure. (Tr. 1931, IPL Exh. EB-1, Schs. B-1, p. 94, B-3, p. 19) IPL has senior unsecured debt with a negative debt provision that prevents IPL from issuing secured debt unless it extends the benefits of any such liens to the holders of the unsecured debt. This means that the rating of any secured debt issued would match that of the unsecured debt. Therefore, Mr. Gorman improperly reflects IPL's risks relative to the proxy group in his results.

Mr. Gorman chose to exclude the results of his constant growth DCF model because of issues with his growth rate; however, he did not provide empirical evidence that his growth rate could not exceed the GDP during a five- to ten-year period. (Tr. 1551) In fact, Mr. Gorman's own workpapers references *The Fundamentals of Financial Management*, by Eugene Brigham and Joel Houston, that states, "Dividends for mature firms are often expected to grow in the future at about the same rate" as the GDP. (Tr. 1837, 1918) The authors also stated, "On this basis one might expect the dividends of an average, or 'normal' company to grow at a rate of 5 to 8 percent a year." (Tr. 1919) Mr. Gorman's growth rate of 5.57 percent falls within this range. (Tr. 1919)

Assuming there are no other issues with Mr. Gorman's DCF analysis, by including the results from his constant growth DCF analysis within his ROE recommendation, his upper range would increase to 10.64 percent. (Tr. 1926)

If one were to consider an outlier, it should not be the 11.76 percent ROE from Mr. Gorman's constant growth model. It should be the 10.65 percent result from his "sustainable growth" model. This result is 74 basis points lower than the next highest result of 11.39 percent (using his multi-stage DCF model) where the highest result of 11.76 percent is only 37 basis points higher than the 11.39 percent result. Removing the lowest result from the analysis would than increase the upper end of his ROE analysis to 10.79 percent. These minor corrections bring Mr. Gorman's results closer to Mr. Hanley's.

Criticisms of Consumer Advocate witness Vitale's Analysis:

First Mr. Vitale made errors in his workpapers and could not verify why. Numbers used in Docket No. RPU-08-1 and again used in this docket were not the same. Additionally, he goes back and forth between citations of former and current test references to try to discredit IPL's testimony.

Consumer Advocate Initial

Initial Brief: pp. 84, 87-93

First Consumer Advocate explains that the stock price in the market place reflects ascertainable information, and this is supported by author Morin who IPL also cites. Mr. Morin states:

> A considerable body of empirical evidence indicates that U.S. capital markets are efficient with respect to a broad set of information, including historical and publicly available information. (Tr. 1691)

Because capital markets are efficient, the DCF model is a reliable method to use in determining the ROE when the stock price is higher, lower, or equal to the book value. (Tr. 1689-1691, 1694) IPL is wrong to believe that the price is established independently of investors' cost of common equity. Price is based on publicly available information which would include market-to-book ratios. (Tr. 1693)

In using the DCF model, Consumer Advocate witness Vitale used a 3-month average price ending in May 2009. IPL, instead, used spot prices which can be impacted by substantial aberrations. (Tr. 1698-1699)

For the dividend, Mr. Vitale annualized the most recent indicated dividend; whereas, IPL adjusted this dividend by unsubstantiated forecast of future dividends. This inflated its dividend. (Tr. 1699-1702)

In estimating the growth rate using reasoned analysis, it is important for that rate to reflect common equity's long-run horizon. Mr. Vitale used the earnings, dividends, book value, and internal growth rates for each company along with judgment to estimate the appropriate growth rate. (Tr. 1719-1720, Exh. GV-1, Sch. L, p. 3) This is consistent with what investors do. Historical information is available to investors in stockholders' reports, on websites, and in the financial press and is the starting point for reliable analysis. (Tr. 1710-1711)

However, IPL mechanically considered forecasted growth rates for the next five years which are unreliable. The Board explained, in *Interstate Power and Light Co.*, Docket No. RPU-02-3, p. 61, that the common equity should not be based on mechanical calculations. Five-year growth rates also create a mismatch since common equity has a perpetual life, are considered inflated, and are normally provided without supporting information regarding assumptions, data, and analysis. (Tr. 1719)

Mr. Vitale determined a 10.0 percent ROE for Alliant and a range of 9.7 percent to 10.8 percent with an average of 10.4 percent ROE for his proxy group. These estimates fall within IPL's DCF ROE range of 7.9 percent to 29.9 percent. IPL needed to use the median DCF result of 10.7 percent in order to avoid distortion by unrepresentative results. (Tr. 1721-1722)

<u>ICC Initial</u>

Initial Brief: pp. 33-40, 45-46

ICC witness Gorman uses three versions of the DCF model which when averaged produced an 11.0 percent ROE.

Constant Growth DCF model:

This model produced an 11.76 percent ROE. However, Mr. Gorman did not include this result in his recommended ROE because he believes that the results from this DCF model are not reasonable and should not be used since both the dividend yield and the growth rate are inflated. The dividend yield reflects the decline of utility stock prices caused by the recent concerns about the economy, utility sales, and reductions to capital programs. The growth rates are also excessive; they exceed the U.S. Gross Domestic Product (GDP) growth rate of 5.1 percent. The GDP represents a ceiling for a utility's sustainable growth rate since a company cannot indefinitely growth faster than the market it sells its product into. This has been observed by the Energy Information Administration (refer to Ex. MPG-10) and supported by published analyst literature and academic work. In Brigham's and Houston's textbook, "Fundamentals of Financial Management," it explains:

> The constant growth model is most appropriate for mature companies with a stable history of growth and stable future expectations. Expected growth rates vary somewhat among companies, but dividends for mature firms are often expected to grow in the future at about the same rate as nominal gross domestic product (real GDP plus inflation).

Also there was a study in *Morningstar*'s *Stocks, Bonds, Bills and Inflation 2008 Yearbook Valuation Edition* that compared dividends of the stock market with GDP growth over the time period 1926 to 2007 and found that they have historically grown in tandem with the overall economy.

The GDP growth rate is a high-end estimate since utility companies are less risky compared to the market as a whole.

Sustainable Growth DCF Model:

Mr. Gorman also uses a sustainable growth DCF where he calculates the proxy group's internal growth rate using *Value Line*'s three- to five-year earnings and dividends projections as well as the earned ROE. The internal growth methodology is connected to the earnings retained within a company. This represents funds remaining after dividends are paid that can be reinvested into the company (one minus dividend payout ratio). The proxy group's average internal growth rate is 4.41 percent. Using the price and dividend data from the constant DCF analysis with this growth rate produces a ROE of 10.65 percent.

Multi-Stage Growth DCF Model:

In addition, a multi-stage growth DCF model is used. This model reflects the possibility of non-constant growth for a company over time. The following three growth periods are included: 1) short-term growth period of five years (source: consensus analysts' growth projections), 2) a transition period consisting of the next five years (source: the five-year projection adjusted for GDP growth), and 3) a long-term growth period starting in the 11th year and going into perpetuity (source: consensus analysts' projected growth for the U.S. GDP of 5.1 percent published in *Blue Chip Economic Indicators*). The same price and dividend data from the constant growth model were used. The ROE for the proxy group is 11.39 percent. Averaging each of the three DCF calculations produces an 11.0 percent ROE.[37]

Criticisms of IPL witness Hanley's DCF Analysis:

Mr. Hanley uses high growth rates which inflate his DCF results and are not sustainable. Because his results have many outliers, Mr. Hanley uses his

[37] Actually it is the second and third DCF calculations (i.e., 11.39 percent and 10.65 percent) that produce an 11.0 percent ROE. The Brief is incorrect to state all three results produce the 11.0 percent ROE estimate.

median results instead of an average. The median growth rates for his proxy group and Alliant respectively are 5.83 percent and 5.65 percent. These growth rates exceed the GDP growth rate of 5.1 percent, the ceiling, by 55 to 73 basis points. Using Mr. Hanley's proxy group and Alliant, Mr. Gorman applies his multi-stage growth outlook and estimated a range of 10.42 percent to 10.52 percent ROE instead of Mr. Hanley's DCF range of 10.66 percent to 10.78 percent.

IPL Reply

Reply Brief: pp. 27-29

Consumer Advocate uses dated text to support its position that the DCF model is the model to focus on and other models should be used as a check. A more recent version of Consumer Advocate's provided text states:

> While it is certainly appropriate to use the DCF methodology to estimate the ROE, there is no proof that the DCF produces a more accurate estimate of the ROE than other methodologies. Sole reliance on the DCF model ignores the capital market evidence and financial theory formalized in the CAPM and other risk premium methods. The DCF model is one of many tools to be employed in conjunction with other methods to estimate the ROE. It is not a superior methodology that supplants other financial theory and market evidence. The broad usage of the DCF methodology in regulatory proceedings in contrast to its virtual disappearance in academic textbooks does not make it superior to other methods. The same is true of the Risk Premium and CAPM methodologies. (2006 edition *New Regulatory Finance*) (Tr. 1493)

Consumer Advocate also mischaracterizes IPL's position regarding the use of the DCF model when the market values differ from book values. Consumer Advocate claims that IPL erred by asserting the markets fail to reflect the ROE of investors when prices do not match book value. (OCA Brief, p. 87) What IPL states is "when market values depart from book values, a market-based DCF cost rate applied to the book value of common equity will not reflect investors' expected common equity cost rate based on market prices." (Tr. 1496). This shows another limitation of the DCF model and why it is important to use other models as well.

Finally, there is continuous attack by Consumer Advocate on the use of forecasted growth rates. Its evidence to support discarding forecasted growth rates is limited and anecdotal compared to the significant amount of evidence provided by IPL. The evidence shows that "reliance on analyst forecasting is a significant factor for investors . . .." (Tr. 1600-1602)

Consumer Advocate Reply

Reply: p. 22

IPL unfairly criticizes Consumer Advocate witness Vitale's insignificant error regarding the formula used for the 1999 average book value in his Exhibit GV-1, Schedule E, page 2. (Tr. 1800) "It is clear that IPL's entire argument concerning Mr. Vitale is nothing more than an ad hominem attack." (OCA Reply, p. 22)

ICC Reply

Reply Brief: pp. 17-21

ICC's DCF analysis is not inaccurate as asserted by IPL. IPL claims that ICC witness Gorman wrongly compared IPL's senior secured credit rating" to the senior secured credit rate of the proxy group. Mr. Gorman relied on the same proxy group in performing his DCF analysis as IPL witness Hanley's. Whether IPL has a secured or unsecured debt rating does not change Mr. Gorman's conclusion that IPL's risk is comparable to the risk of the proxy group.

IPL also argues that Mr. Gorman should not have excluded the results of his constant growth model because the growth rate exceeded the GDP growth rate. Mr. Hanley does not provide evidence to the contrary. "To be sure, IPL cited to a 2007 publication that states that 'dividends for mature firms are often expected to grow in the future at about the same rate' as the GDP and that 'one might expect' that dividends of an 'average' or 'normal' company to grow at a rate of 5 to 8 percent a year." (ICC Reply, p. 20; IPL Initial, p. 100) There is a distinction between the growth rate that exceeds GDP and the same growth rate, and IPL did not provide studies that state that the growth rate of a utility can exceed the GDP over the long term.

Mr. Gorman also explains that this is the only reason he excluded the constant growth model results not because he felt it was a high outlier as claimed by IPL.

Staff Analysis

For review, the DCF model calculates the ROE that equates the current stock price and present value of expected cash flows, including future dividends and price appreciation. Mathematically, the DCF formula is:

$$k = D/P + g$$

where: k is the investors' required return on common equity
D is the dividend per share
P is the market price per share
g is the expected rate of growth in dividends per share

Although all three ROE witnesses, IPL witness Hanley, OCA witness Vitale, and ICC witness Gorman, include a DCF analysis, they each use a different version of the DCF model. Mr. Vitale uses the continuous form of the DCF model where the dividend is not grown; Mr. Hanley uses the FERC version where the dividend is increased by one-half the growth rate; and Mr. Gorman uses the constant growth model where the dividend is grown by the full growth rate along with two other variations of the DCF model (i.e., sustainable growth and multi-stage growth models). The Board has accepted the FERC form in the past as a compromise model between the continuous and constant growth models.

In Iowa Southern, "Final Decision and Order," Docket No. RPU-89-7, September 14, 1990, pp. 28-39, the Board laid out its preferred DCF analysis in detail. The Board: 1) accepted the FERC DCF model that grows dividends by one-half the growth rate, 2) used 6-month average prices, 3) looked at both historical (10-year DPS and 10-year internal growth) and analysts' forecasts of EPS, and 4) used combination gas and electric proxy.

Below highlights what the parties used for each input of the model:

Dividend Yield:

To determine the appropriate dividend yield, one begins with the annualized indicated dividend, which is taking the current quarterly dividend and multiplying it by four. All parties agree to start there. How much growth to reflect in that dividend component is what gives rise to the various models as discussed above.

Next, the price of the utility's stock needs to be determined. Although, the Board has favored using at least a 6-month average price, none of the parties provide that much market price data. IPL uses a spot dividend yield for February 6, 2009, and an average of dividend yields for December 2008 and January 2009 where the market price on the last trading day of each of the two months was used. Consumer Advocate uses a 3-month average price ending in May 2009, and ICC uses 13-weeks of weekly high and low prices ending June 19, 2009. To note, Consumer Advocate has used 12-month average prices as recently as in the Black Hills case, Docket No. RPU-08-3; however, it has decided to only include three months of prices in this case. It claims, "An average price over this period is more likely to be representative and better reflect current capital market conditions" (Tr. 1698) where as IPL's prices would not.

The Board uses the parties' data for these inputs in the past since the Board is tied to the record. As part of the decision making process the Board could place more emphasis over one set of data versus another. For example, Consumer Advocate and ICC use approximately three months of prices, which Consumer Advocate explains is more appropriate given the market conditions, while IPL focuses on data for three different dates that

date back over nine months ago during a time where the market was more volatile. Given that Consumer Advocate and ICC provide approximately 3-months of prices which resembles more the Board's preferred method of using 6-months of prices versus IPL's version of spot prices and that Consumer Advocate and ICC's prices are several months more recent as well, the Board may want to give more weight to the results produced by these two parties.

Growth Rates:

What growth rates to use in the DCF model is the most debated input of the DCF model between the parties. Mr. Vitale relies on historical data and reasoned judgment to determine the appropriate growth rate for each of his proxy companies. He uses growth in book value, dividends, earnings, and calculates the internal growth rate. This represents the actual performance of the utility. According to Mr. Hanley, this does not represent investors' expectations. He, instead, proposes the Board approves his 5-year forecasted earnings growth rates from *Value Line* and from *Reuters*. For each company in his proxy group and for Alliant, the range of growth rates was 2.10 percent to 22.0 percent. Mr. Vitale objects specifically to Mr. Hanley's use of forecasted growth rates because the analysts tend to be overly optimistic, which will overstate the ROE, and the growth rates are only forecasted for the next five years when common equity has an indefinite time frame.

Mr. Gorman recommends that the GDP growth rate of 5.1 percent be the ceiling for the sustainable long-term growth rate of a utility instead of the three- to five-year growth rate of the proxy group, because the proxy group growth rate exceeds the growth rate for the overall U.S. economy, which cannot be sustained indefinitely. Mr. Hanley states that there is no empirical evidence supporting this concern. However, Mr. Gorman cites different sources to support his position. Mr. Gorman also calculates the internal growth rate, which represents the earnings retained within the company, of his proxy group and determined an average growth rate of 4.41 percent.

Mentioned in testimony but not briefed, Mr. Hanley also states that Mr. Vitale's range of historical data for each company represents a hodgepodge method. Staff reviewed Mr. Vitale's growth rates, and Mr. Hanley is correct that there is no consistency to what was used as estimates for each company. It varied from the 10-year historical growth in book value per share, 10-year retention growth, recent retention growth, and 10-year earnings per share. Mr. Vitale, however, did provide reasoning in his Exhibit GV-1, Schedule L, pages 3 to 5, for how he selected the ranges he did. To note, both Mr. Vitale and Mr. Hanley admit that expert judgment is applied when determining the appropriate ROE for a utility which is what Mr. Vitale used in coming up with his growth rate ranges.

Although there is significant amount of testimony devoted to whether one should use historical or forecasted growth rates, the Board has shown preference to both. Each has its own advantages and disadvantages. More specifically, the Board has used the 10-year DPS and 10-year internal growth and analysts' forecasts of EPS as mentioned earlier.

The only issue that may need to be specifically addressed with respect to growth rates is whether it was appropriate for Mr. Gorman to ignore the results of his constant growth model because he believes that the growth rate used in the model was inappropriate since it exceeded the GDP growth rate of 5.1 percent.

Results

A summary chart follows that compares the three parties' DCF approaches as well as the variability shown for the various inputs.

DCF Differences	IPL-Hanley	OCA-Vitale	ICC-Gorman
Dividend[38]	$D_0(1+0.5g)$	D_0	$D_0(1+g)$
Price	3 Spot Prices	3-month Avg.	Avg. of weekly hi/lows over 13 weeks
Growth	Analysts' 5-yr. forecasts of EPS	Emphasizes ○ Internal Growth ○ BVPS	○ Analysts' 5-yr. forecasts of EPS ○ 3 to 5-year Value Line Projections ○ Internal Growth ○ GDP Growth
Proxies	○ Electric ○ Combo E/G ○ Alliant	○ Alliant ○ Combo E/G	○ Electric ○ Combo E/G

[38] To reiterate, D_0 is the latest annualized indicated dividend.

The primary DCF results are as follows:

Witness	Methods Used	Results
IPL's Hanley (Tr. 1480)	DCF Return ($D_{1/2}$) (using 10 utility proxies and Alliant)	10.66 - 10.78%
OCA's Vitale (Tr. 1747)	Continuous DCF (using Alliant and 4 Utility Proxies)	Alliant 10.0% Proxy 9.7 - 10.8% (avg. 10.4%)
ICC's Gorman (Tr. 1842)	Sustainable growth DCF Return (using 11 utility proxies)	10.65%
ICC's Gorman (Tr. 1842)	Multi-stage growth DCF Return (using 11 utility proxies)	11.39%

IPL admits that the market conditions have changed enough for IPL to adjust its recommendation by 60 basis points. Staff then cautions the Board about giving too much weight to IPL's DCF analysis because it reflects outdated market data. The assumption can be made that IPL's DCF range of 10.66 percent to 10.78 percent range should be somewhat less. To note, IPL chose to use the median of his results instead of the average because the DCF results produced such a large range. Referring to Mr. Hanley's Exhibit (FJH-1), Schedule G, the range of his DCF results was 7.93 percent to 29.94 percent. The 29.94 percent was an obvious outlier while the remaining estimates ranged between 7.93 percent and 12.05 percent. It is not clear why Mr. Hanley did not just simply remove this outlier and then average the remaining estimates instead of using the median value. Removing the 29.94 percent result from the DCF average for the proxy group produces a 10.49 percent ROE.

Focusing more on the average results produced by Consumer Advocate and ICC, the DCF range would be 10.2 percent[39] to 11.00 percent[40]. The lower end of the range represents a conservative estimate since it is based on Consumer Advocate's continuous DCF model (that reflects no growth) and the higher end is based on ICC's DCF models that reflect full amount of growth in its results. Therefore, the Board may place more emphasis on a value somewhere in the middle of the range that may represent more the Board's preferred method, the FERC model. The midpoint of this range is **10.60 percent**. This appears reasonable when one assumes that IPL's DCF result of 10.66 percent and 10.78 percent was determined during market conditions that were somewhat worse than when ICC and Consumer Advocate prepared their testimony.

[39] This averages Alliant's DCF result of 10 percent with Mr. Vitale's average DCF result of 10.4 percent for his proxy group. (OCA Exh. (GV-1), Schedule M).
[40] As a reminder ICC's recommended DCF result of 11.0 percent was determined by averaging the 10.65 percent ROE and 11.39 percent ROE.

Sub-issue: Risk Premium Method

IPL Initial

Initial Brief: pp. 103-106

IPL witness Hanley uses the simple risk premium model, which takes a company-specific long-term debt interest rate and adds an associated risk premium to estimate the ROE. The theory behind this model is that common equity shareholders expect to earn a return higher than what could be earned investing in long-term debt, since they are last to receive any claim on assets and earnings. (Tr. 1503)

Mr. Hanley determines three different interest rates to use: 1) his estimated projected bond yield on Moody's A-rated utility bonds of 6.49 percent, which he explains is the most appropriate rate to use; 2) the average yield for the 12-month A-rated utility bonds ended January 2009 of 6.53 percent because the Board, in its recent order in Docket No. RPU-08-1, used this rate; and 3) the most current yield on A-rated utility bonds of 6.39 percent for January 2009. (Tr. 1504)

For his risk premium, Mr. Hanley first calculates a risk premium of 6.8 percent using the beta approach. (Tr. 1506-1513; IPL Ex. FJH-1, Sch. K, pp. 5-6) The use of betas is meaningful because they "reflect the investors' expectations over a long-term future investment horizon." (Tr. 1506) Using both historical and forecasted risk premiums, Mr. Hanley only gave 20 percent weight to the forecasted risk premium since it likely did not represent long-term market conditions. (Tr. 1511-1513; 1664)

Next a risk premium of 4.65 percent was determined using a mean equity risk premium based on a study using the holding period returns of public utilities with A-rated bonds. (Tr. 1513; IPL Exh. FJH-1, Sch. K, p. 5) The 4.65 percent risk premium was then averaged with the 6.8 percent risk premium to produce the 5.73 percent risk premium used in Mr. Hanley's risk premium analysis.

Regarding the Board's risk premium analysis, Mr. Hanley suggests that the Board's risk premium range needs to be increased. (Tr. 1514-1516, 1651-1652) ICC witness Gorman's attacks Mr. Hanley's suggestion by claiming that there is no empirical evidence to support the inverse relationship between interest rates and equity risk premiums. He is wrong because Mr. Hanley's study covering a 20-year period provides empirical evidence; Mr. Hanley's use of Mr. Gorman's data provide the same empirical demonstration; and there is a discussion regarding this relationship in an excerpt from *New Regulatory Finance* found in Exhibit 22.

Consumer Advocate Initial

Initial Brief: pp. 98-99

IPL's proposal to raise the Board's risk premium range is not market based. Investors' expected ROE is determined in capital markets. (Tr. 1741) IPL wrongly uses the review of authorized returns determined by regulators as support for this increase. This is an exercise in circularity and does not rely on prices in the market place. The Board found flaws with the comparable earnings approach because this approach relied on realized returns on book equity and not information reflected in the market place. This logic could be applied to the regulatory authorized return approach used to show the inverse relationship in this case.

ICC Initial

Initial Brief: pp. 22-32, 46-50; Exhibit MPG-18

In the past the Board has indicated that it gives significant weight to its own risk premium analysis where it adds 250 to 450 basis points to the current yield on A-rated utility bonds. ("Final Decision and Order," *Interstate Power and Light Co.,* Docket No. RPU-08-1, p. 60) Using this approach would produce a ROE of 10 percent consistent with ICC witness Gorman's recommendation. (Tr. Dt, p. 26) That is adding 6.46 percent A-rated bond yield (i.e., current and three-month average) to the risk premium range produces 9.0 percent to 11.0 percent ROE with a midpoint of **10.0 percent**.

ICC witness Gorman performs his own risk premium analysis. He calculates two estimates using a bond yield plus equity risk premium model. For the bond yields he uses a utility bond yield from Moody's Utility Bond Yields and Treasury bond yields from *Blue Chip Financial Forecasts.* The 12-month utility bond yield ending June 2009 was 6.6 percent which reflected the abnormally high yields found in October and November 2008. The three-month average from April to June of 2009 was 6.37 percent. Currently the bond yield is under 6 percent. Therefore using the more recent yields would produce even lower results. The 30-year Treasury bond yield is 4.6 percent.

To estimate equity risk premiums, Mr. Gorman compares regulatory commission-authorized returns and bond yields (first, to treasury bonds and then to single A-rated utility bonds) for years 1986 through 2008.

He finds the equity risk premium of allowed returns over Treasury bond yields ranging from 4.4 percent to 6.08 percent. Adding this to a projected long-term Treasury bond yield of 4.6 percent produces an estimated ROE from 9.0 percent to 10.68 percent. The midpoint is **9.84 percent**.

Mr. Gorman then finds the equity risk premium of allowed returns over Moody's A-rated utility bond yields ranging from 3.03 percent to 4.39 percent. Adding this to a 13-week average yield on A-rated utility bonds of 6.46 percent (time period ending June 19, 2009) produces an estimated ROE of 9.49 percent to 10.85 percent. The midpoint is **10.17 percent**.

Mr. Gorman's risk premium analysis ranges from 9.84 percent to 10.17 percent with a midpoint of **10.0 percent** which is consistent with the results from the Board's risk premium method.

Criticisms of IPL witness Hanley's Risk Premium Analysis:

Mr. Hanley's risk premium of 4.65 percent is inappropriate to use since Mr. Hanley did not update his data to make it consistent with the time period used in other parts of his risk premium analysis. He calculated the common stock total return using data up to the end of 2007 and then uses a 12-month average bond yield ending January 2009. There is over a year difference in the timing of this data. Second, Mr. Hanley relies on income return instead of total return. Income return ignores the changes in annual bond prices. Updating Mr. Hanley's study to reflect data up to June 2009 and correcting his use of interest return on bonds with total return on bonds produces an updated risk premium of 3.98 percent. Adding this risk premium to the current three-month average bond yield of 6.4 percent produces a ROE of 10.4 percent.

Mr. Hanley's risk premium of 6.8 percent is also flawed. He only applied the beta estimate to part of the market risk instead of the all of the market risk thereby overestimating the risk premium for utility companies with a beta of less than one. He also uses an inflated market return estimate of 28.85 percent. Therefore, this risk premium needs to be rejected.

<u>IPL Reply</u>

Reply Brief: pp. 31-32

First IPL explains that there is an inverse relationship between interest rates and risk premiums which is supported by IPL witness Hanley's empirical evidence. This was also demonstrated using ICC's own data as shown in IPL Exhibit FJH-2, Schedule D. Lastly, an excerpt from *New Regulatory Finance*, included in Exhibit 22, discusses the inverse relationship. Consumer Advocate ignores this when it suggests that risk premiums are declining.

In response to ICC criticisms, IPL states the following: IPL's A3 bond rating is more risky than the proxy group's A2 average bond rating; only the income return is appropriate in the calculation of equity risk premium; and the use of beta as a means of allocating equity risk premium is correct. (IPL Reply, p. 32)

Consumer Advocate Reply

Reply Brief: p. 21

IPL chooses to use its unsupported risk premium range of 400 to 500 basis points above the A-rated utility bond yield instead of 250 to 450 basis point risk premium used by the Board. IPL's range is not market based and should not result in an estimate of what investors' expect as a premium over bonds.

IPL incorrectly relied on authorized returns determined by regulators as justification for increasing the Board's range. This is an exercise in circularity. Also the same reasons that the Board used to reject the comparable earnings approach are applicable to the regulatory authorized return approach. *See Davenport Water Co.*, 76 PUR3d 209, 241 (ISCC 1968).

Staff Analysis

The simple risk premium model takes an interest rate and adds an associated risk premium to estimate the ROE. The idea behind this model is that investors require a premium to assume additional risk. Equity investment is generally riskier than debt because there is no contractual return as there is for debt, and the equity investor is last in line to receive funds in case of a bankruptcy. Therefore, equity investors require a higher return.

A risk premium is the difference in required or expected returns between two specific securities with different risks. It is important to match a given risk premium with the appropriate type of debt rate. If the Board chooses to use the A-rated utility average yield as the debt rate, then the risk premium of utility equity over and above the A-rated debt yield is the relevant risk premium.

Both IPL witness Hanley and ICC witness Gorman use some form of risk premium analysis while Consumer Advocate witness Vitale does not. Mr. Hanley uses many steps to produce ROE estimates for his proxy group and for Alliant based upon both historical and forecasted risk premiums. The average risk premium is 5.73 percent. He then adds this to three different bond yields to produce his ROE range of 12.12 percent to 12.26 percent. He also takes Mr. Gorman's data and produces an additional risk premium analysis. This analysis results in an average ROE of 10.94 percent, (reflecting an adjustment for IPL's A3 bond rating). Mr. Hanley recommends a ROE of **12.26 percent** based on his risk premium analysis. In summary, Mr. Hanley's risk premium analysis is complicated and gives 20 percent weight to a forecasted market risk premium of over 28 percent. Both Mr. Gorman and Mr. Vitale agree that a market return estimate of over 28 percent is excessive and not sustainable in the long term.

Mr. Gorman estimates equity risk premiums by comparing regulatory commission-authorized returns and bond yields (first, to Treasury bonds and then

to A-rated utility bonds) for years 1986 through 2008. He then adds these two risk premiums to, respectively, projected Treasury bond yields and 13-week average yield on A-rated utility bonds. Mr. Gorman believes it is appropriate to use the time period 1986 to 2008 because stock was consistently trading above book during this time. This shows that the authorized returns on common equity supported a utility's ability to issue common stock without diluting existing shares. (Tr. 1843) Mr. Hanley argues that this time period is too short. He uses data from 1926 to 2007.

Mr. Gorman risk premium analysis supports a ROE range of **9.84 percent to 10.17 percent**, with a midpoint of **10.0 percent**. Mr. Vitale argues Mr. Hanley's empirical study (discussed below) that uses commission-authorized returns as data exercises in circularity. This argument could be used against Mr. Gorman's risk premium analysis as well.

The Board in recent years has given significant weight to its own risk premium method. The Board's method has evolved to adding a risk premium range of 250 to 450 points to the current A-rated utility bond rate and to a 12-month average yield. Mr. Gorman also included this method as part of his analysis. Adding the most current yield of 6.2 percent (June 2009) and the three-month average yield of 6.37 percent to the Board's risk premium, Mr. Gorman calculates a ROE range of 9.0 to 11.0 percent, with a midpoint of 10 percent. He did not recommend the 12-month average yield of 6.6 percent because in October and November 2008, the yields were much higher because the impact of the financial crisis. At hearing, ICC offered the following updated A-rated utility yields: 1) July 2009 – 5.97 percent and 2) August 2009 – 5.71 percent.

Obviously yields have been declining since the parties filed their testimony. Using the most recent information in the record (Exhibit MPG-19, p. 3, and Tr. 1620), staff updated the average yield on A-rated utility bonds to 6.3 percent. This reflects a twelve-month average for the time period September 2008 to August 2009 excluding the months of October and November. Staff agrees with Mr. Gorman that those two months were greatly influenced by the market conditions at that time. Adding the Board's risk premium range of 250 to 450 basis points to the 6.3 percent yield produces an 8.8 percent to 10.8 percent range. This is 7 basis points off of what Mr. Gorman used in his analysis. He apparently rounded up his range to 9.0 percent to 11.0 percent. Staff finds Mr. Gorman's range to be reasonable.

Mr. Hanley provides empirical evidence covering a twenty-year period that supports the inverse relationship between risk premiums and interest rates. He also provides additional empirical evidence using Mr. Gorman's data that supports this inverse relationship. Based on his analysis, Mr. Hanley suggests that the Board's risk premium range needs to be increase, and he recommends a 400 to 500 basis point risk premium.

Both ICC and Consumer Advocate argued against raising the risk premium. ICC explains that it is not appropriate to assume that a change in a nominal interest rate should justify a change in the risk premium. First the volatility of interest rates change over time where in the 1980's it was most volatile, and interest rates are impacted by inflation. Second, the risk premium should be based on the difference in perceived risks of investing in bonds vs. in equity. Consumer Advocate believes that Mr. Hanley's analysis is circular because it was partially based on a regression analysis of authorized rates of return from 309 litigated electric cases. It also criticizes the analysis for not being market based.

The Board's risk premium range was last updated in Docket No. RPU-93-6. (Tr. 1515) According to IPL the A-rated utility bond yield was 7.3 percent at that time. That case is over 15 years old. During that time the yields on A-rated utility bonds have ranged between a high of 8.98 percent for November 1994 to a low of 5.40 percent for June 2005. The most current yield in the record of 5.71 percent falls within the low end of this range. During that time, with the wide variety of utility bond yields, the Board did not feel compelled to adjust its risk premium range.

Staff finds it difficult to recommend the Board make a substantive change to a risk premium range that has existed over the past decade and a half where interest rates have varied significantly over that time based on empirical studies done by one witness who uses an article as additional support. The other parties provide notable arguments against Mr. Hanley's proposal.

Below highlights the results of the parties' risk premium analyses:

Witness	**Methods Used**	**Results**
IPL's Hanley (Tr. 1514)	Risk Premium	12.12 - 12.26% (uses 12.26%)
(Tr.1562; FJH-2, Sch. E)	Risk Premium using Mr. Gorman's Data	10.94% (adjusted)
ICC's Gorman (Tr. 1846)	Risk Premium (T-Bonds and A-rated Utility Bonds)	9.84 - 10.17%
(Tr.1865)	Adjusted RPM Analysis of Hanley's	10.40%
(Tr. 1847)	Board Method (A-rated bond yield of 6.4%)	10.00% (midpoint)
	Updated Board Method	8.8 - 10.8%

Recommendation: It is obvious from the above table that Mr. Hanley's results are significantly higher than the results provided by Mr. Gorman and produced by the Board's risk premium method. Mr. Hanley proposes a 12.26 percent ROE using his risk premium model which is impacted by his reflection of the

forecasted market risk premium of nearly 29 percent and his 12-month average yield on A-rated utility bonds of 6.53 percent ending January 2009 which is outdated. Additionally, Mr. Hanley uses many steps within his risk premium methodology to determine his ROE estimates. More emphasis could be placed on Mr. Gorman's results which are consistent with the results produced the Board's risk premium model. Both the Board's risk premium method and Mr. Gorman's analysis support a ROE of **10.0 percent**. However, staff notes that the Board is not tied to using the midpoint of the Board risk's premium range when imposing an equity return.

Sub-issue: Capital Asset Pricing Model (CAPM)

IPL Initial

Initial Brief: pp. 106-108

Two versions of the CAPM are used: the traditional model and the empirical CAPM (ECAPM) The ECAPM takes in account the empirical Security Market Line (SML) (as reflected in the traditional CAPM) is not as steeply sloped as the predicted SML. (Tr. 1521) The recommended ROE after averaging the two models is 11.33 percent.

Risk-Free Rate:

For the forecasted risk-free rate, IPL witness Hanley uses 3.38 percent. This is the average of six quarters of consensus forecasts of the yield on 30-year U.S. Treasury Notes ending with the second quarter 2010. (Tr. 1522, Exhibit FJH-1, Schedule O, p. 3) In Mr. Hanley's opinion these Notes are almost risk free and are consistent with the long-term investment horizon of utility common stocks. (Tr. 1522-1523; IPL Exh. FJH-1, Sch. O, p. 3)

Risk Premium:

For the expected market premium, Mr. Hanley weights his forecasted and historical risk premiums consistent with his risk premium analysis. (Tr. 1524) The weighted risk premium is 10.77 percent.

Beta:

For his beta figures, he uses betas of .70 for both his proxy group and for Alliant. (Tr. 1524)

Using all these figures, Mr. Hanley calculates the CAPM and ECAPM K (ROE) estimate for each of his comparable groups as shown in the table below.

Hanley's CAPM	CAPM	ECAPM	Recommendation
Electric Combo Electric/Gas	10.92%	11.73%	11.33%
Alliant	10.92%	11.73%	11.33%

ICC witness Gorman is wrong to make the claim that the use of the adjusted beta double counts the risk and return adjustment when using the ECAPM. (Tr. 1868-1869) *New Regulatory Finance* states no double counting exists. (Tr. 1572-1573, IPL Exh. 21)

Consumer Advocate Initial (Reply is similar)

Initial Brief: pp. 93-98, 103
Reply Brief: p. 23

Although Consumer Advocate witness Vitale uses the CAPM in combination with his DCF model to determine the ROE for Alliant, he believes that the DCF model is superior. The DCF analysis takes into account the timing and risks of future cash flows (referring to author Morin) (Tr. 1723) while the CAPM indirectly estimates the investors' expected returns and its results are quite volatile. (Tr. 1724, 1727-1728)

Risk-Free Rate:

Mr. Vitale used a 20-year Treasury bond yield for his risk-free rate of 5.7 percent. (Tr. 1724-1726)

Risk Premium:

The geometric mean market return for S&P 500 of 9.6 percent is the appropriate mean to use in determining the risk premium. It is commonly used in finance, is partially relied on to measure actual growth, compounded returns, and expected returns; is not distorted by unrepresentative returns, and is a best measure of past returns and best indicator of expected returns. (Tr. 1726-1727) Subtracting the risk-free rate of 5.7 percent from 9.6 percent estimated market return produces a risk premium of 3.9 percent. (Tr. 1730) Mr. Vitale does not rely on the arithmetic mean because it assumes normal distribution of stock returns when that is not the case and is known to be upwardly biased. (Tr. 1769-1770)

IPL wrongly used the projected arithmetic mean of 12.3 percent in its analysis. This estimate is overstated. It is in excess of both the geometric mean of 9.6 percent and the arithmetic average of 11.7 percent estimated by *Morningstar*.

IPL also relied on a forecasted five-year market return of 29 percent. (Tr. 1735) This produced an estimated risk premium of over 25 percent. This greatly overstated its cost of common equity estimate. (Tr. 1735-1737)

Beta:

Betas used by Mr. Vitale are *Value Line* adjusted betas. For both Alliant and his proxy group, Mr. Vitale used a beta of .70. (Tr. 1732) Incorporating the beta into the model, the CAPM produces a ROE of **8.4 percent**. (Tr. 1735)

ECAPM:

It was unnecessary for IPL to include the ECAPM in its analysis since the 20-year Treasury bond yields as the risk-free rate and *Value Line's* adjusted betas were used. Therefore, the ECAPM is redundant, unwarranted, and should not be used. (Tr. 1733-1734)

According to *Morningstar*, there has been a decline rather than increase in risk premiums due to the decrease in the volatility in the stock market and increase in the volatility of bonds. (Tr. 1739-1739) This has been noted in professional journals and the financial press, and investors are aware of this. (Tr. 1740-1741)

ICC Initial

Initial Brief: pp. 40-44, 50-53

ICC witness Gorman applies the basic CAPM equation to his proxy companies.

Risk-Free Rate:

For the risk-free rate (R_F), he uses 4.6 percent. This is the Blue Chip Financial Forecasts projected 30-year Treasury bond yield. (June 1, 2009.)

Risk Premium:

For the expected market premium (R_M - R_F), he presents both a historical estimate and a prospective estimate.

- For the *historical* estimate of expected market return (R_M), he uses *Morningstar*'s arithmetic average of achieved total return on the S&P 500 over the period 1926-2007 (12.3 percent) and subtracts the total return on long-term treasury bonds of 5.8 percent to produce a 6.5 percent market risk premium.

- For the *prospective* R_M, he sums Ibbotson's historical arithmetic average real market return over the period 1926-2007 (9.0 percent)

and a consensus analysts' inflation projection (2.0 percent) to produce 11.18 percent expected market risk return. Then he subtracts his estimated risk free rate of 4.6 percent (*Blue Chip Financial Forecast's* projected 30-year Treasury bond yield) from 11.18 percent to produce his 6.58 percent market premium.

Beta:

For his beta (β), he relied upon the average *Value Line* betas for the comparable group. The estimate is 0.65. (Exh.__(MPG-20))

Using all these figures, Mr. Gorman calculates CAPM estimates a 8.83 percent and 8.88 percent ROE based upon respectively the historical premium and prospective premium with a midpoint of 8.85 percent.

Mr. Gorman's risk premium range is consistent with the results produced by *Morningstar*. *Morningstar's* risk premium range is 6.2 percent to 7.1 percent. The high end represents the total market return minus the income return of the risk free rate. Mr. Gorman does not agree that the income return be used, because it does not reflect the true investment option. The low end represents an adjustment to the 7.1 percent risk premium for the "abnormal expansion of price-to-earnings ('P/E') ratios relative to earnings and dividend growth during the period 1980 through 2001." (ICC Brief, p. 44) Mr. Gorman's risk premium of 6.5 percent falls within this range.

Criticisms of IPL witness Hanley's CAPM Analysis:

There are three major areas of concern regarding Mr. Hanley's CAPM analysis. First, Mr. Hanley's estimated market return is overstated; it implies a growth rate of 25.49 percent (subtracting the risk free rate of 3.38 percent from the total market return of 28.85 percent). This growth rate is not sustainable in the long term, and it is more than twice the projected growth in GDP. Additionally Mr. Hanley relies on the highest market risk premium estimate found in *Morningstar*. After further review of this publication, Mr. Gorman found a market risk premium range of 6.2 percent to 7.1 percent instead. Using Mr. Hanley's updated data combined with this risk premium, the ROE estimate would be 8.92 percent and 10.92 percent for the proxy group and Alliant, respectively.

Second, Mr. Hanley's ECAPM needs to be rejected. By using the adjusted beta from *Value Line*, he is double counting the increase to a CAPM return estimate for utility betas less than 1.0. The effect of *Value Line's* adjustment is to flatten the SML. Lastly, the "manipulation" of the beta within the ECAPM is not reflective of market information. The investors use beta estimates published in *Value Line* to make investment decisions.

IPL Reply

Reply Brief: pp. 29-32

There are four specific areas of criticisms made by the other parties that IPL will address regarding IPL witness Hanley's CAPM analysis. First Consumer Advocate continues to support the use of the geometric mean because it provides the best measure of past performance. (OCA Brief, p. 94) IPL argues that the appropriate mean to use is the arithmetic mean because the ROE estimate is forward looking. As stated by *Morningstar*:

> For use as the expected equity risk premium in either the CAPM or the building block approach, the arithmetic mean or the simple difference of the arithmetic means of stock market returns and riskless rates is the relevant number. This is because both the CAPM and the building block approach are additive models, in which the cost of capital is the sum of its parts….
>
> The arithmetic mean equates the expected future value with the present value; it is therefore the appropriate discount rate. (IPL Exh. FJH-2, Sch. Q, pp. 3-4).

Second Consumer Advocate claims that Mr. Hanley's ECAPM is redundant to its CAPM analysis. As stated in Morin's *New Regulatory Finance*, the ECAPM is not an adjustment in beta. This use of ECAPM and an adjusted beta are two separate features of asset pricing.

Third IPL does not agree with Consumer Advocates suggestion that risk premiums are declining. As discussed under the risk premium section, Mr. Hanley has provided empirical evidence that there is an inverse relationship between interest rates and risk premium that Consumer Advocate chooses to ignore.

Finally, ICC believes that Mr. Hanley's CAPM analysis is flawed because he uses adjusted betas which double counts the risk and return adjustment. As explained when addressing Consumer Advocate's similar criticism above, Morin states that using adjusted betas and the ECAPM "comprise two separate features of asset pricing." (Tr. 1573)

Staff Analysis

The CAPM Equation, $K = R_F + \beta (R_M - R_F)$, is used by IPL witness Hanley, Consumer Advocate witness Vitale, and ICC witness Gorman. Based on empirical evidence, Mr. Hanley also uses the empirical CAPM (ECAPM) because the traditional CAPM underestimates the ROE for companies with betas less than one. Mr. Gorman and Mr. Vitale both agree that it is unnecessary to use the

ECAPM since they already use the adjusted betas provided by *Value Line* which adjusts for that concern. Therefore, Mr. Hanley is double counting the risk/return adjustment.

The Board traditionally has not placed much reliance upon any CAPM analysis. Years ago there were concerns about its reliability. However, the Board may want to give it some weight in this proceeding since all three witnesses agree to use it and its use has grown in popularity. Mr. Hanley, on page 46 of his direct testimony, references Intermediate Financial Management, by Eugene F. Brigham and Phillip R. Daves, where they state:

> Recent surveys found that the CAPM approach is by far the most widely used method. Although most firms use more than one method, almost 74 percent of respondents in one survey, and 85 percent in the other, use the CAPM. This is in sharp contrast to a 1982 survey, which found that only 30 percent of respondents used the CAPM.

For the risk-free rate (R_F), Mr. Hanley uses 3.38 percent (average of six quarters of average consensus forecasts of the yield on 30-year U.S. Treasury Note yields); Mr. Vitale uses 5.7 percent (geometric average yield on 20-year Treasury bonds from *Morningstar*); and Mr. Gorman uses 4.6 percent (projected 30-year Treasury bond yield).

For the expected market premium ($R_M - R_F$), Mr. Hanley uses 10.77 percent, an average of projected and historical estimated market premiums. The historical market risk premium included was 7.1 percent. Mr. Vitale uses the long-run geometric mean for the S&P 500 of 9.6 percent for his market return, and therefore produces a market premium of 3.9 percent after subtracting his risk free rate of 5.7 percent. Mr. Gorman uses an historical risk premium of 6.5 percent and perspective risk premium of 6.58 percent. To note at hearing, ICC provided evidence showing that Mr. Hanley's historical market risk premium has decreased from 7.1 percent to 6.5 percent. (Tr. 1622-1623; ICC Exh. 302)

For his beta (β) figures, Mr. Hanley uses company-specific *Value Line* adjusted beta of 0.70 for both his proxy group and for Alliant. Mr. Vitale also uses a 0.70 beta for his proxy group and for Alliant. Mr. Gorman relies upon the average *Value Line* betas for his utility proxies, which he has determined to be 0.65. Beta is not an issue.

The primary differences reflect the following:

- Mr. Gorman and Mr. Hanley use arithmetic averages while Mr. Vitale uses geometric. The former are higher than the latter.
- Mr. Gorman and Mr. Vitale feel that Mr. Hanley's additional step of using ECAPM double counts the increase to the CAPM return when *Value Line's* adjusted betas are used which all parties do.

- Mr. Vitale and Mr. Gorman criticize Mr. Hanley for using income return on bonds and not total return.
- Mr. Vitale and Mr. Gorman believe that Mr. Hanley's projected market return of 28.85 percent is excessive and not sustainable and should not be used.

The CAPM results are as follows:

Witness	***Methods Used***	**Results**
IPL's Hanley (Ex. FJH-1, Sch O)	CAPM using Utility Proxies and Alliant	10.92%
(Ex. FJH-1, Sch O)	ECAPM using Utility Proxies and Alliant	11.73% Recommends 11.33%
OCA's Vitale (Tr. 1735)	CAPM of Alliant and Utility Proxies	8.2 – 8.6% Avg. of 8.4%
ICC's Gorman (Tr. 1852)	CAPM using Mr. Hanley's Proxy	8.83 – 8.88% midpoint of 8.85%

Again Mr. Hanley's analysis gives weight to the forecasted market risk premium of over 28 percent, which helps increase his results well above ICC's and Consumer Advocate's analysis. Also, as provided by ICC and acknowledged by IPL, the market risk premium has decreased from 7.1 percent to 6.5 percent. Therefore, Mr. Hanley's results are arguably overstated.

Determining the appropriate market risk premium and the appropriateness of using the ECAPM are the two major issues in the parties' CAPM analysis. These are two issues that have consistently been presented in past IPL rate cases before the Board; however, the Board has not taken a position on either issue even as recently as in IPL's advanced ratemaking principles case, Docket No. RPU-08-1. As mentioned above, the Board has not explicitly used the results from this model in past ROE decisions. If the Board chooses to give some weight to the CAPM in this case without selecting which party's method is most appropriate, the Board could simply take the midpoint of the two extremes, which is 10.0 percent rounded, or give equal weight to each party's analysis in determining the ROE which would also produce an average ROE of 10.0 percent rounded.

Issue: Overall Return on Equity Recommendation

A logical place for the Board to start would be with the recommendations provided by the three parties: Consumer Advocate and ICC recommend a 10.0 percent ROE and IPL recommends approximately 10.8 percent ROE without the

adders (discussed below). Therefore the range is 10.0 percent 10.8 percent, with a midpoint of 10.4 percent.

Next the Board should review the range of results produced from the various models used by the parties. Focusing first on the DCF analysis: the range proposed by staff is 10.2 percent to 11.0 percent. This reflects Consumer Advocate's average result at the low end of the range and ICC's proposed average DCF result of 11.0 percent at the high end. Although Mr. Hanley's DCF results are somewhat dated, his results fall at the upper end of this range (i.e., 10.66 percent to 10.78 percent.) Also worthy to note is that this is the only model where the parties' results are not drastically far apart. This may provide good reason to give more weight to the DCF results.

The next model is the CAPM. Unfortunately the parties are very far apart and may suggest issues with this model in this rate case. Both Consumer Advocate and ICC's analysis produce results in the 8.4 percent to 8.85 percent range, respectively which appears to be very low compared to other interest rates provided by Consumer Advocate in its testimony that were used to support its 10.0 percent ROE and compared to the results produced by the DCF model and the risk premium method. IPL recommends its 11.33 percent average result which reflects the use of two variations of the model, of which one ICC and Consumer Advocate take issue with. As stated above, averaging the CAPM results two different ways produces a ROE of around 10 percent. The Board may want to give little weight to this model.

Finally, the Board has the risk premium results produced by IPL and ICC as well as the results from its own risk premium model to consider in its decision-making process. Again IPL and ICC's analyses are far apart. IPL recommends a ROE of 12.26 percent, which represents the highest of the three risk premium results he provided and again includes dated information. It is also approximately 146 basis points higher than even IPL's updated ROE recommendation of around 10.8 percent. Closer to IPL's updated recommendation is the results it produced using ICC data, (i.e., 10.6 percent (not reflecting IPL's adders). ICC, instead, recommends a 10.0 percent return, the midpoint of its range. This is the same midpoint that is produced by the Board's risk premium method. ICC also includes additional risk premium analysis using Mr. Hanley's information. This analysis resulted in a ROE of 10.40 percent. Removing IPL's 12.26 percent risk premium recommendation as an outlier, the average risk premium would be 10.25 percent by averaging ICC's recommended 10.0 percent risk premium ROE, the Board's risk premium analysis, IPL's additional risk premium analysis of 10.6 percent, and ICC's additional risk premium analysis of 10.4 percent. Also the Board could also use the range of 10.0 percent to 10.6 percent, with a midpoint of 10.3 percent. The results are similar.

Based on the above information staff recommends a ROE range of 10.0 percent to 10.6 percent. The 10.0 percent is supported by the both ICC and Consumer

Advocate's recommended ROE, by both ICC's risk premium analysis and the Board's risk premium method, and is the average of all parties' CAPM analysis. The 10.6 percent reflects the upper end the risk premium range and is the midpoint of the staff's recommended DCF range.

Sub-issue: Business and Financial Risk Adjustment

IPL Initial

> Initial Brief: pp. 97, 102

IPL adjusts his recommended ROE upwards to reflect the additional business risk due to IPL's small size relative to the proxy group. IPL further increases the ROE to account for IPL's lower bond rating. (Tr. 1480, 1481-1485, 1485-1486)

Consumer Advocate witness Vitale uses dated text to support his position that a size adjustment is not necessary. However, the updated text included in the 2006 *New Regulatory Finance* provides the following remarks:

> The relationship between firm size and return cuts across the entire spectrum but is most evident among smaller companies that have higher returns than larger ones on average. (IPL Exhibit No. 11, p. 182)
>
> In addition to earning the highest average rates of return, small stocks also have the highest volatility, as measured by the standard deviation of returns. (IPL Exhibit No. 11, p. 185)
>
> Smaller companies are less able to deal with significant events that affect revenues and cash flows than large companies. (IPL Exhibit No. 11, p. 187)

Consumer Advocate Initial

> Initial Brief: pp. 88-89, 103-104

The Board stated the following in its order in *Interstate Power and Light Co.*, Docket No. RPU-02-3, p. 63:

> Because the various models consider so many factors, it is difficult to isolate any one item, such as size, and make that the basis for an additional adjustment.

The same can be said about the financial risk adjustment proposed by IPL. (Tr. 1707-1708)

IPL also recognizes that markets are efficient; however, IPL ignores this fact when it proposes its small size adjustment. The small size effect is already reflected in the stock price that investors pay for an asset because the price reflects the knowledge of publicly available information.

IPL relies on Malkiel in its testimony who believes the size adjustment is erroneous and states that the indication of the small firm affect is likely the result of data mining. (Tr. 1772-1773)

The CAPM assumes returns are normally distributed, which they are not. And that academic research that supports the small firm premium is based on the CAPM as if all the components were accurate. "Company then relied on the divergence between the estimated CAPM returns from actual returns as support for its small firm adjustment to its cost of common equity estimates." This divergence likely shows the limitation of the model rather than supporting the existence of a small firm effect.

Assuming that there is justification for the adjustment, the adjustment would be redundant since IPL includes at least two companies smaller than IPL, assuming it was a stand-alone company, in its sample.

ICC Initial

Initial Brief: pp. 55-58

In Docket No. RPU-08-1, the Board found that no additional adjustment for business risk and financial risk was needed to the ROE given that the proxy group and IPL had comparable bond ratings. The Board should also reject it this case.

Specifically, IPL witness Hanley decides a 19 basis point adder for business risk is necessary, because he believes that his proxy group is four times larger than IPL based on market capitalization.

Mr. Hanley relies on *Morningstar* data for companies in the third and fourth deciles in estimating his size adjustment. The companies included are unregulated with beta factors well above one. Comparing these companies to a low-risk utility company is flawed.

The proxy group that Mr. Hanley and ICC witness Gorman use already reflects similar overall risk to IPL including risk attributable to size because they have comparable bond ratings and comparable business profile score. Credit rating analysts consider risk factors applicable to small companies when assessing a utility's investment risk. Therefore, this risk is already reflected in the ROE estimate.

Regarding the financial risk adder, it is also flawed and should be rejected. Mr. Hanley compares the average Moody's credit rating of his proxy groups to IPL's. The proxy group's average rating is A2 which has slightly lower risk than IPL's bond rating of A3. He determines that a 20 basis adder is appropriate. However, even Mr. Hanley states, "similar bond ratings reflect similar combined business and financial risks" which contradicts the need for the adjustment.

IPL Reply

Reply Brief: pp. 24-27

Size Adjustment

Based on the arguments presented by both ICC and Consumer Advocate, they have a misunderstanding of the size adjustment. First, they both state that the adjustment is unwarranted because the proxy group is similar enough to mitigate size concerns. Consumer Advocate also states that since two of Mr. Hanley's proxy companies are smaller than IPL the adjustment is unnecessary.

They both miss the point: the proxy group is not identical to IPL. (Tr. 1578) Both IPL's and ICC proxy group on average is much larger than IPL, and the results are based on the average of the group. Therefore, a size adjustment is proper. (Tr. 1577-1579)

Consumer Advocate also provided a quote from a Board order, in Docket Nos. RPU-02-3, RPU-02-8, and ARU-02-1 to support its position that an adjustment is not necessary; however, the sentence that preceded it stated:

> Based on the testimony, the Board is concerned the proxy companies used by IPL in determining ROE may be more risk than IPL, offsetting an adjustment due to size.

The comparable companies in this case are less risky than IPL; therefore a size adjustment is warranted.

Also Consumer Advocate inaccurately paraphrases a statement made in a recent *Morningstar* publication. It claims that this publication stated that "returns are not normally distributed." (OCA Brief, p. 104). What *Morningstar* actually stated was, "the historical returns of large company stock are not exactly normally distributed…" Mr. Hanley demonstrated that returns during the 1926 through 2007 time period are essentially normally distributed meaning they are random. (IPL Exh. FJH-1, Schedule L, p. 6)

ICC claims that IPL wrongly looks at companies included in the third and fourth deciles which have betas in excess of one when IPL's proxy group has a beta of only 0.70. However, ICC does not recognize that the companies in the third and

fourth deciles have had their betas reviewed over a 81-year period of time while *Value Line*'s betas cover only a 5-year time period. *Value Line's* betas were used for the proxy group. Therefore, this is an apple to orange comparison.

Mr. Hanley uses industry-specific data and reliable statistics to derive his size adjustment. Additionally, he is only asking for a 16 to 19 basis point adjustment even though his achieved result was 65 to 75 basis points. (Tr. 1576-1578)

Finally, IPL repeats the quotes from the 2006 *New Regulatory Finance* as provided above.

Financial Adjustment

Both ICC and Consumer Advocate offer the same argument for this adjustment as they did for the size adjustment and that is since the proxy group is similar to IPL, an adjustment is not necessary. (Tr. 1578) Again, the proxy group is not identical to IPL and has an average bond rating that is one notch better than IPL (i.e., A2 versus A3).

Consumer Advocate Reply

Reply Brief: pp. 20-21

In its initial brief, Consumer Advocate explains why both the business risk and financial risk adjustments are inappropriate. In its reply brief, Consumer Advocate again provides the language from a previous Board order explaining why the Board rejected such adjustments.

Staff Analysis

Size Adjustment

Because IPL is similar but not identical to IPL witness Hanley's proxy group, Mr. Hanley adjusts his ROE estimates for his utility proxy and for Alliant upwards to reflect IPL's greater business risk attributable to its comparatively small size. As a conservative estimate he increases his ROE estimate by 16 basis points for his proxy group and 19 basis points for Alliant.

Consumer Advocate witness Vitale and ICC witness Gorman both argue against such an adjustment. In testimony Mr. Vitale argues the focus should be on Alliant, not IPL, as the appropriate company for ROE analysis. He asserts that the size of Alliant makes the need for risk adjustment unnecessary. Mr. Vitale also states, assuming the adjustment is prudent, IPL includes at least two companies in his proxy that are smaller than IPL therefore the adjustment is not necessary.

Mr. Gorman argues that since Mr. Gorman and Mr. Hanley's utility proxy groups reasonably emulate an investment grade bond rating, the proxy groups reasonably capture IPL's small size risk and all other risk factors, and there is no need to add a size premium to the ROE estimate for the proxy group.

Mr. Hanley in response to both parties' criticisms states that the proxy represents a group of companies similar in risks to IPL but not identical. Therefore, adjustments need to be made. He provides pieces of text from *Morningstar* Valuation Yearbooks as support for his position for his size adjustment.

Finally both ICC and Consumer Advocate reference past Board decisions and more specifically, the Board's recent decision in Docket No. RPU-08-1 where the Board stated:

> IPL made an upward adjustment to ROE to reflect what it believes is IPL's greater business risk attributable to its relatively small size. Consumer Advocate argued the focus should be on Alliant, not IPL, and the ICC said that the proxy groups used by ICC and IPL reasonably capture IPL's small size risk (as well as all other risk factors). The Board has not made such adjustments in the past and is not persuaded here that an upward adjustment for IPL's size is warranted. (Final Decision and Order, issued February 13, 2009, p. 62)

Similar arguments were made in this case. Given the Board decided this same issue with the exact same parties arguing for and against this adjustment earlier this year, for consistency the Board could again find it has not been persuaded to change its position on this issue.

Financial Risk Adder

Because IPL has a A3 bond rating compared to the bond rating of A2 for Alliant and to the average bond rating of A2 for IPL witness Hanley's proxy group, Mr. Hanley proposes to increase his ROE estimate by 20 basis points. Because the proxy group and Alliant are similar but not identical, he feels this is necessary.

Again both Consumer Advocate and ICC argue against the financial risk adjustment using similar arguments that were made against the business risk adjustment. They believe it is flawed and should be rejected.

Staff provides another reference from the recent Board Order in Docket No. RPU-08-01, where the Board provided the following language with respect to the financial risk adjustment:

> IPL also proposed an 11 basis points upward adjustment to reflect IPL's greater degree of financial risk as compared to the combination proxy group and Alliant. The Board will not adopt such an adjustment, as IPL's

witness testified that similar bond ratings reflect similar combined business and financial risks. Since those in IPL's proxy group have similar bond ratings, no further adjustment should be necessary. (Order, p. 62)

Recommendation: Consistent with the decision the Board made on these two adjustments just months ago, the Board should again reject IPL's proposed business risk adjustment and financial risk adjustment in this case.

B. Capital Structure

Introduction:

The capital structure is often composed of three types of capital: long-term debt, preferred equity, and common equity. The balance and cost rate needs to be determined for each to come up with the overall weighted cost of capital to apply to rate base in a rate case proceeding.

In this case both IPL and Consumer Advocate use the traditional method of calculating the cost rate for long-term debt and preferred equity consistent with the method the Board has approved in the past. Therefore, that is not an issue. However, determining the balance of each component is. IPL is proposing the Board deviate from extensive past Board precedent to approve a year-end capital structure, while Consumer Advocate supports the continued use of the thirteen-month average capital structure. Both updated their proposed capital structures in their rebuttal testimony to reflect changes that occurred outside IPL's proposed 2008 test year. The changes impact both long-term debt and common equity and were made with the mindset to maintain IPL's credit rating under the current guidelines. IPL feels this is important in order for it to have continued access to the capital markets at reasonable rates especially with the significant capital expenditures it has made and will make. To note, at hearing IPL was asked to correct an error found by Consumer Advocate with respect to unamortized long-term debt balances that were not included in its calculations. IPL filed Late-Filed Exhibit 23 with those corrections. However, staff notice one major issue with the new proposed capital structure and that is IPL changed its common equity balance to reflect the September 2009 balance and by doing so has increase the common equity ratio above 50 percent. IPL made a commitment to not request a capital structure with a common equity ratio in excess of 50 percent in the ITC reorganization case, Docket No. SPU-07-11. Consumer Advocate, in its brief, continued to use the uncorrected capital structure included in IPL's rebuttal testimony. Further discussion on this new issue is provided later.

There are three major issues the Board will need to decide in determining the appropriate capital structure to use in this docket. They are whether: 1) to use a thirteen-month average capital structure or a year-end capital structure; 2) to

include Consumer Advocate's preferred stock adjustments; and 3) to apply double leverage. There is one other issue tied to the preferred equity adjustments that impacts the common equity balance that will be addressed under the preferred equity adjustment issue.

Sub-issue: Thirteen-Month Average vs. Year-End Capital Structure

IPL Initial

Initial Brief: pp. 92-95; IPL Late-Filed Exh. 23

IPL witness Bacalao acknowledged at hearing that an error was made about not reflecting the $25 million in unamortized debt premium, discount, expense, and loss on reacquired debt for the $300 million debt issued on July 10, 2009. After correcting this error and reflecting the actual contributions of equity to IPL during 2009, IPL is now proposing the following capital structure:

Year-End Capital Structure
December 31, 2008 (Updated)

Capital	Balance	Ratios	Rate	Wtd. Cost
Long-Term Debt	$1,138,851,583	42.744%	6.802%	2.907%
Preferred Equity	$183,134,419	6.874%	8.410%	0.578%
Common Equity	$1,342,352,542	50.382%	11.200%	5.643%
Total	$2,624,045,825	100.000%		9.128% (1)

(1) The actual exhibit reflects an overall weighted cost of capital of 9.229 percent because it included the 11.4 percent ROE originally recommended by IPL and not the updated ROE of 11.2 percent.

(Source: Late-Filed Exhibit 23, Exhibit__(EB-1), Schedule A, page 2 of 2 and IPL Initial Brief, pages 92 and 93.)

IPL supports the use of a year-end capital structure that reflects post-test year financings because it is more representative of IPL's capital structure. (Tr. 654) The 13-month average capital structure is only accurate if there is a steady state which is not currently the case.

The Board should approve IPL's recommend weighted average cost of capital because IPL's credit quality is dependent upon the capital structure determined,

and because a test year adjusted capital structure is more reflective of the current and forward-looking environment.

Consumer Advocate Initial

Initial Brief: pp. 49-50, 53-57; Ex. SJP-3, Sch. A

Consumer Advocate uses a 13-month average capital structure reflecting pro forma adjustments that occurred between January 2009 and September 2009 consistent with the intent of Iowa Code § 476.33(4). (Tr. 1217-1228) These adjustments included equity infusions in May and August 2009, the issuance of long-term debt in July 2009, and the redemption of long-term debt in August 2009. (Tr. 666) Below is Consumer Advocate's proposed capital structure:

Capital	**Balance**	**Ratios**	**Rate**	**Wtd. Cost**
Long-Term Debt	$1,131,430,877	43.428%	6.842%	2.971%
Preferred Equity	$183,609,920	7.048%	7.646%	0.539%
Common Equity	$1,290,258,747	49.524%	9.517%(1)	4.713%
Total	$2,605,299,544	100.000%		8.223%

(1) This is equal to the Alliant's overall cost of capital reflecting a ROE of 10.0 percent.

IPL, instead, uses a year-end capital structure ending December 31, 2008, also including the same pro forma adjustments. IPL chooses not to use the 13-month average capital structure, because it is not representative of the capital structure going forward and it would not allow IPL to recover its "properly incurred cost of capital". (Tr. 653-654, 700)

Although the two parties disagree with what type of capital structure is appropriate to use, there is little difference in the actual values proposed by each party meaning the capital structures are very similar. (Tr. 668, 1235-1236) Board member Hanson even asked at hearing how Consumer Advocate witness Parker's capital structure could be damaging to IPL given that the capital ratios are very similar. (Tr. 716) IPL responded that first the double leverage calculation would have a revenue impact of $8 or $9 million. (Tr. 716-717) Second, IPL would find it helpful to set precedent of using the actual capital structure opposed to an average one. (Tr. 717)

It made no sense for IPL to discuss double leverage in the context of Mr. Hansen's question. Double leverage is a separate issue from the type of capital structure that should be used.

Second part of IPL's answer shows the true intent of IPL. "Because the capital ratio differences in the parties' proposed capital structures in this case are so slight, such new precedent would only be of value to IPL if it could be used to provide greater profit in future cases." (OCA Brief, p. 54) Since Alliant controls equity infusions, the payment of IPL's dividends to Alliant, and IPL's issuance or retirement of long-term debt and preferred stock, Alliant can control the timing of these transactions such that IPL's year-end capital structure provides a higher return than the average capital structure.

Additionally, the matching principle would be violated if the Board approved the use of a year-end capital structure, and "the Iowa legislature codified the matching principle in its statuary requirement that the Board 'consider verifiable data that exists within nine months after the conclusion of the test year, respecting known and measurable changes in costs not associated with a different level of revenue, and know and measurable revenues not associated with a different level of costs.'" Iowa Code § 476.33(4) (2009) (OCA Brief, p. 55)

The year-end capital structure does not represent the actual capital that was invested in a test year average rate base, and it relies on account balances that occurred on a single day. Balances can vary with every accounting entry. For example, Consumer Advocate witness Parker showed how IPL's retained earnings were higher nine out of ten years at year end compared to an average balance for the 1999 to 2008 time period. (Tr. 1215; Exh. SJP-1, Sch. D, p. 1)

IPL can pay dividends or return capital to Alliant thereby reducing its common equity balance. If the year-end capital structure is higher than the average capital structure, ratepayers would pay return on common equity and associated income taxes to IPL on dividends already paid to Alliant, capital no longer invested by IPL in its assets.

The Board needs to continue the use of the 13-month average capital structure with adjustments consistent with Iowa Code § 476.33(4).

IPL Reply

Reply Brief: pp. 19-20

IPL reiterates that although the difference between the parties' proposed capital structure is not significant in this case, (OCA Brief, p. 50; Tr. 1235-1236) it may not be the case in the future. IPL's proposed 2008 year-end capital structure is the appropriate one to use.

Determining the optimum capital structure serves the interest of both customers and shareholders; the utility will be able to secure funding at the lowest cost of capital. (Tr. 653-654) It is counterintuitive and counterproductive for IPL to artificially increase the weighted average cost of capital as suggested by Consumer Advocate.

Consumer Advocate claims that IPL's capital structure would violate the matching principle because it "is not representative of the actual capital that was invested in the rate base…" (OCA Brief, p. 55) However, Consumer Advocate failed to recognize that accumulated depreciation, accumulated deferred income tax, and utility plant in service are computed using year-end balances. (Tr. 741) IPL is wishing for the same treatment for its weighted average cost of capital since it addresses more appropriately the existence of IPL's non-steady state.

Consumer Advocate Reply

Reply Brief: p. 14

IPL stated that although there is not a significant difference between IPL's and Consumer Advocate's capital structure, the differences between year-end versus 13-month average capital structures "have the potential to cause much greater rifts in the future." (IPL Initial, p. 95) Consumer Advocate agrees with IPL that there is a potential for greater differences. IPL wants to establish precedent in order to manipulate its capital structure to obtain excess profits. The Board has stated in its order in *Interstate Power Co.,* Docket No. RPU-83-27, p. 11, that "It is undesirable to adopt a single date as the time for determining a Company's capital structure. It affords an opportunity to alter the structure to the Company's advantage should it choose to do so."

Staff Analysis

There is a long history of the Board approving the use of a 13-month capital structure, and Consumer Advocate provides several reasons why the 13-month average capital structure should continue to be used over a year-end capital structure.

First, the average capital structure with pro forma adjustments does not violate the matching principle and is consistent with statutory requirement in Iowa Code § 476.33(4) (2009) where it states the Board "consider verifiable data that exists within nine months after the conclusion of the test year, reflecting known and measurable changes in costs not associated with a different level of revenue, and know and measurable revenues not associated with a different level of costs." Additionally the Iowa Supreme Court described the matching principle as follows (staff provided):

> It is fundamental to a proper test year that costs (both investment and operating) and revenues match, i.e., that they be consistent with each other. Unless there is a matching of costs and revenues, the test year is not a proper one for fixing just and reasonable rates. The inclusion of costs without matching revenues will produce excessive rates. The inclusion of revenues, without the matching costs will deny the utility reasonable rates. The relationship between costs and revenues for the test period used and the validity of that relationship constitutes one of the most vital areas in the determination of just and reasonable rates.
>
> If actual test year costs are adjusted to include costs associated with a higher level of revenues than prevailing in the test year, it is obvious that there is an improper matching of costs and revenues, unless the revenue level is adjusted. Davenport Water Company v. ISCC, 190NW2d 583, 605 (Iowa 1971)

One reason for the 13-month average capital structure is so that it will match with the 13-month average rate base. In this case, both IPL and Consumer Advocate have accepted a 13-month average rate base for the test year 2008 adjusted for changes occurring beyond the test year consistent with the above mentioned Iowa Code. However, IPL explains that Consumer Advocate did not acknowledge major rate base items that were reflected as year-end balances such as accumulated depreciation, accumulated deferred income tax, and utility plant in service (Tr. 741) when discussing how IPL's method would violate "the matching principle."

Both Consumer Advocate and IPL agree to include these major rate base items assuming that they existed for the entire year. Similarly Consumer Advocate also included the major pro forma adjustments to the capital structure as if they existed for the entire year consistent with IPL. It appears to staff that there is consistency between the parties with the adjustments made to both rate base and the capital structure while still using thirteen-month averages for other items.

IPL also claims that it is important to look at the most current capital structure during times where there is secular change and not so much when there is a cyclical change such as seasons and economic cycles. Mr. Bacalao explains that he is referring to two parts when discussing about secular change. The first part is the actual capital structure and the response of credit agencies and investors to the changes in the financial markets. The second part is the relative cost to raise money, which is a function of the capital structure. (Tr. 713-714)

By reflecting these pro forma adjustments nine months beyond the test year the above legislative language helps address utility concerns that test year rate cases do not reflect major changes going forward. These adjustments obviously reduce actual differences between a 13-month average capital structure and a

year-end capital structure when comparing the capital ratios proposed by each party in this case.

Finally, Mr. Bacalao admitted at hearing that his proposed capital structure would violate the matching principle given the parties' have accepted a 13-month average rate base in this case. (Tr. 717-718)

Second, the 13-month average capital structure is not impacted by one-time events which could have a significant impact on the capital structure used for setting rates. Each of the accounts balances could change with every entry made into the accounting books. Consumer Advocate provided an example of this with respect to retained earnings and demonstrated how for IPL its retained earnings were higher at the end of the year compared to the average throughout the year for the majority of the ten years Consumer Advocate reviewed.

By giving weight to one day out of the year instead of taking a year average increases the risk of reflecting aberrations in the capital structure as well.

Third, a thirteen-month average capital structure helps prevent a utility from making adjustments at the end of the test year to increase its cost of capital going forward. Both parties agree that the difference between each party's proposed capital structures is not significant. According to Consumer Advocate, the importance of this issue for IPL appears to be for future rate cases. Because the year-end capital structure represents a more appropriate capital structure for a utility in a non-steady state (which is what IPL witness Bacalao claims is IPL's situation), IPL wants the Board to change its long precedent of approving the use of the thirteen-month average capital structure and approve a year-end capital structure instead.

Consumer Advocate believes this proves IPL's intent for setting this new precedent and that intent is for IPL to profit from it in future rate cases. IPL argues that it counterproductive for IPL to try to increase its weighted average cost of capital. Its goal is to find the optimum capital structure for both its ratepayers and shareholders.

Recommendation: There is nothing new in this record that supports a change from a long history of using a 13-month average capital structure. Given that the parties' proposed capital structures are not far apart in this case shows that Consumer Advocate's use of a 13-month average capital structure will not negatively impact IPL's financial situation. However, in its next rate case, if by using the 13-month average capital structure does not reflect the secular change that IPL is referring to in this case, IPL can once again provide evidence to show how this issue may need to be changed.

One other matter is that if the Board approves IPL's capital structure instead, there is an issue that neither party caught in briefs. IPL, in the transmission

case, committed to not filing a capital structure with a common equity ratio greater than 50 percent. However, when the Board at hearing requested IPL to file on a late-filed basis a capital structure that corrected the error of not reflecting $25 million in unamortized debt balances for the new debt issue, IPL also made changes to its common equity balances. The end result was increasing the common equity ratio to 50.382 percent. A negative adjustment in excess of $20 million would need to be made to the common equity balance to get it back to 50 percent.

Sub-issue: Preferred Equity Adjustment

IPL Initial

Initial Brief: pp. 94-95

IPL disagrees with Consumer Advocate's proposed preferred equity adjustments for both the 1979 preferred stock exchange and the 2002 retirement of the legacy preferred stock. (Tr. 1220-1228) IPL witness Bacalao provides a list of reasons as to why to the 2002 retirement of preferred stock was necessary (not included in brief). (Tr. 701-702) Even though the benefits are difficult to quantify they are real and tangible. (Tr. 702-703)

Consumer Advocate Initial

Initial Brief: pp. 50-53, 57-64

Consumer Advocate proposes to make three preferred stock adjustments. Two adjustments are related and have been previously approved by the Board. They deal with the 1979 Preferred Stock Exchange. In 1979, Interstate Power Company (IPC) chose to replace cheaper preferred stock with more expensive preferred stock. The Board reversed this preferred stock exchange as if it had not occurred, because IPC exchanged two series of preferred stock (i.e., 4.68 percent and 4.36 percent rates) with higher costing preferred stock of 9.0 percent in order to get an equity gain of $5.5 million. (Tr. 1220) This exchange did not benefit the ratepayers. The second adjustment occurred in May 1993 when IPL redeemed $25,473,750 of the 9 percent preferred stock with $27,250,000 of 6.4 percent preferred stock. (Tr. 1222-1223) The amount of the new 6.4 percent preferred stock above the redeemed amount was reflected in the capital structure. The Board also approved of that adjustment.

IPL, however, did not discuss these two adjustments in its testimony and when asked at hearing what impact the Board decision on the 2002 retirement would have on Consumer Advocate's proposed 1979 preferred stock adjustment, IPL witness Bacalao explained he did not understand the logic for the 1979 preferred stock adjustment. (Tr. 728-729)

The third adjustment is regarding the retirement of seven series of preferred stock made in 2002. The redeemed preferred equity totaled $56.4 million with a weighted average cost of 5.538 percent. (Tr. 1223) Then IPL issued a $150 million preferred stock issue at a cost rate of 8.375 percent in December 2002 and $40 million preferred stock issue at a cost rate of 7.10 percent in September 2003. (Tr. 1223) The new weighted cost of preferred stock is 8.107 percent. (Exh. SJP-1, Sch. E, pp. 4-6) After reflecting the annual decrease in the 6.4 percent series beginning 2003, the weighted average cost of preferred stock would have been 5.413 percent. (Exh. SJP-1, Sch. E, pp. 4-6) Comparing that cost rate to the new cost rate represents a 49.77 percent increase in the cost of preferred stock.

Consumer Advocate attempted to get IPL to quantify any benefits that would come from this exchange, and it was not able to. (Tr. 1225) Additionally IPL does acknowledge that it refinanced the redeemed preferred stock with higher costing preferred stock. (Tr. 725-726)

Consumer Advocate calculated a $1.7 million increase in the costs to ratepayers annually (a conservative estimate). (Tr. 1225; Exh. SJP-1, Sch. E, pp. 7-8) IPL has not provided any evidence showing that the benefits from the 2002 retirement offset this increase in costs. Therefore, the Board needs to make the adjustments to protect the customers from this unjustified increase in costs.

Final issue to address is regarding IPL's common equity balance. Because there was only a paper gain that resulted from the 1979 preferred equity exchange and no true benefit for the ratepayers, the Board has consistently removed approximately $5 million from common equity. IPL failed to make this adjustment, and it is not clear whether this was intentional or not. There are no arguments made against this adjustment in the record. Therefore, no matter how the Board decides the 2002 retirement adjustment, the common equity adjustment needs to be made. Common equity needs to be reduced by $4,787,738 if the Board approves of Consumer Advocate's adjustments, and if the Board rejects these adjustments, the common equity balance needs to be reduced by $5,542,967. (Workpaper-SJP, Sch. E, pp. 7-8.)

IPL Reply

Reply Brief: pp. 20-22

IPL witness Bacalao provided the history of the different series of preferred stock at hearing to get clarity as to why IPL decided to retire all seven series of preferred stock in 2002. Below highlights the history given:

- Four of the seven series was issued by IPC (Dubuque) and three of the seven series was issued by IES Utilities (Cedar Rapids).

- IPC went through a capital reorganization, during the late 1940s and early 1950s.
- The covenants reflected the difficulties of that time period for Interstate Power Company and the market conditions.
- One of many covenants that survived decades limited the amount of unsecured debt.
- When the merger occurred between IPC and IES Utilities to form IPL, IPL was subject to those covenants.
- Assets that were merged to form IPL had to be in separate pools and were inconsistent among themselves.
- To do the merger was extremely difficult because it took two or three attempts to get a quorum of the preferred stockholders and was expensive.
- In 2002 IPL decided to call the preferred stock using trust preferred stock that would be treated both like equity and debt. However, due to the fall of Enron, that type of financing became unattractive. To make the best out of a bad situation, IPL issued new preferred stock at a higher cost rate. (Tr. 722-727)

Although the refinance occurred at a higher cost, there are significant benefits. As mentioned by Mr. Bacalao: "How does one quantify avoiding being out of compliance with outdated covenants?" and " How does one quantify opportunities missed in terms of financing on an unsecured basis when you otherwise would have to go on a secured basis, and you're limited by what you can issue?" (Tr. 726)

Consumer Advocate Reply

Reply Brief: pp. 15-16

IPL fails to mention the needed common equity adjustment regardless of how the Board decides the preferred equity adjustments. The adjustment is to remove the hypothetical common equity that was booked in connection with the 1979 preferred stock exchange. Customers should not pay IPL a profit and income taxes on the capital that does not exist.

Regarding the 2002 preferred equity adjustment, IPL claims that Consumer Advocate's adjustment should be rejected because this equity has been retired, is undated, and is not fixed into perpetuity. This reasoning is circular and ignores the fact that the preferred equity transaction increases the cost of preferred equity by nearly 50 percent by 2009. (OCA Initial, pp. 58-61)

Although the benefits of the retirement are not easily quantifiable but are real and tangible as claimed by IPL witness Bacalao, it is difficult to assume that the alleged benefits would offset the $1.7 million annual cost to customers.

Staff Analysis

Consumer Advocate is recommending the Board adopt all three of its proposed adjustments to IPL's preferred stock. The first two relate to the 1979 preferred stock exchange. The third adjustment is with respect to the retirement of seven series of preferred stock in 2002.

1979 Preferred Stock Exchange

IPC, IPL's predecessor, decided to exchange two series of preferred stock with more expensive preferred stock. This resulted in a paper gain of $5.5 million. By increasing the common equity, the ratepayers would have to pay higher capital costs without receiving any benefit. Therefore, the Board reversed this transaction as if had not occurred. Specific adjustments have continued to be made by both Consumer Advocate and more recently by IPL over the years in past rate cases. However, after the 2002 retirement, IPL no longer supported these adjustments.

IPL does not address these adjustments in this case other than to say at hearing that it does not understand the logic behind the adjustments.

2002 Retirement of Seven Series of Preferred Stock

In 2002 IPL decided to retire seven series of preferred stock with dividend rates of 4.68 percent, 4.80 percent, 6.10 percent, 6.40 percent, and 7.76 percent and replace it with preferred stock costing 8.375 percent and 7.10 percent. IPL witness Bacalao provided several reasons justifying the need to replace these seven series of preferred stock. He explained that the benefits are tangible and material to IPL's financial health but difficult to quantify. The benefits include the following:

- The elimination of legacy covenants in the first mortgage indentures that required the observance of a progressively nonsensical separation of assets within IPL as a single entity with the passage of time;
- The elimination of preferred stockholder approval required for asset sales and mergers (which had already resulted in additional and unnecessary costs and delays being incurred in relation to the IPC merger into IES Utilities to form IPL); and
- The elimination of a constraint on the issuance of unsecured debt. (Tr. 702-703)

The preferred stock retirement allowed IPL the freedom to redeem its first mortgage bonds and modernize its corporate charter. "A potential cost avoided, an unnecessary compliance risk avoided, one's access to a particular financial market impeded or an indirect benefit achieved are examples of real costs and

benefits…" (Tr. 703) It would be imprudent to forego important contingent benefits because the benefits are hard to quantify.

However, Consumer Advocate believes that IPL inappropriately retired its seven series of preferred stock with more expensive preferred stock. The total amount of preferred stock was $56.4 million. The increase in dividend costs for ratepayers could be $1.7 million annually. Consumer Advocate does not believe that IPL's reasons for the retirement justify the extra costs especially since IPL could not quantify the benefits. Consumer Advocate does reflect a portion of the $150 million of the 8.375 percent issue and the 7.10 percent issue in its proposed capital structure. This is what is above the amount needed to retire the seven series of preferred stock.

This issue is unfortunately not as cut and dry as Consumer Advocate would like the Board to believe. Consumer Advocate is taken a direct, simple approach by stating that as long as IPL cannot show actual, quantifiable benefits from retiring less expensive preferred stock that at least matches the increase in costs of $1.7 million, the Board needs to reverse this transaction and continue to reflect preferred stock in IPL's capital structure that no longer exists. IPL has explained in great detail the history of the seven series of preferred stock and why IPL needed to replace this preferred stock with new preferred stock. IPL also explains that there are very real, tangible benefits that cannot be easily quantified. Staff believes IPL surely would provide actual numbers if it were able to do so. The question that needs to be answered here is whether IPL was justified in doing what they did based on the reasons given above.

How the Board decides this adjustment directly impacts the 1979 preferred stock exchange adjustment. If the Board believes that IPL was justified in removing outdated covenants even though the benefits were not directly quantifiable and accept that it was reasonable for IPL to retire that preferred stock, the first two adjustments are not needed because the 1979 preferred stock has been retired and no longer exists. However, the one thing that Consumer Advocate recommends adjusting is the common equity balance to remove the paper gain discussed above. The amount would be $5,542,967. Staff agrees with this adjustment. If the Board agrees with Consumer Advocate that IPL did not provide enough support to justify a $1.7 annual increase in capital costs for retiring the preferred stock series, staff recommends the Board implement all three of Consumer Advocate's adjustments.

Sub-issue: Double Leverage

IPL Initial

Initial Brief: pp. 88-92

First, IPL states that Consumer Advocate is applying a version of ring-fencing by recommending double leverage. It is intended to protect the subsidiary from financial recklessness or malfeasance from the parent. There has been no demonstration made that Alliant has had a negative impact on IPL.

IPL notes language from the Board Order in Docket Nos. RPU-02-3, RPU-02-8, and ARU-02-1 where it states that:

> The Board understands the complex nature of these relationships and transactions and will not apply double leverage mechanically in each case, but rather will examine the particular facts and circumstances in each case where the adjustment is proposed. (Order, p. 57)

On page 59 of the same order, the Board also stated that "there may be appropriate exceptions to the application of double leverage other than one based on the four-factor test. . .."

IPL believes that in this case an exception to the double leverage application also applies. Alliant Energy Resources (AER) issued debt in February 2000 for about $402.5 million (nominal value) with Alliant guaranteeing it. (Tr. 734) In November 2008, Alliant assumed this debt; however, there was no cash that flowed to Alliant that could be used to fund an equity infusion into IPL. (Tr. 693, 731-732, 734) "In no way did IPL itself ever assume, whether directly or indirectly, any right, obligation, detriment or benefit under AEC's assumption of AER's debt." (Tr. 694-695)

Alliant extended a tender offer with a deadline of September 28, 2009, and holders tendered 99.96 percent of the notes. Initially, Alliant used $68.8 million of cash on hand and drew down a three-day $170 million bridge loan. (Tr. 736-737, Tr. 1253) Then Alliant issued $250 million of five-year debt with a coupon rate of 4 percent to repay the bridge loan and to pay the additional expenses. (Tr. 735-736) This ended up being a "zero-sum process." (Tr. 736-737)

Consumer Advocate's argument that Alliant's cash on hand can be used for equity infusions is true but it is separate from the actual use of the cash on hand in this case. No cash on hand is attributable to either the $402.5 million assumed debt or to the $250 million debt issuance. In fact, as of the date of hearing, it would have been impossible for any cash replacing the cash on hand used in the tender offer to be used in any equity infusions. That money was deposited in Alliant's bank account before the hearing began. (Tr. 739)

In summary, there was no cash flow when Alliant assumed AER debt back in November 2008. Additionally, the new debt issued in October 2009 to replace the assumed debt did not create any new cash. Therefore, these transactions could not have been used in any cash infusion made to IPL. Since the parent's

debt has not been be demonstrated to support IPL's capital structure, no double leverage adjustment is necessary as set out in the Docket No. RPU-02-3 Order.

Also, Consumer Advocate used the language from *United Telephone Co. of Iowa v. Iowa State Commerce Commission,* 257 N.W. 2d 466, 482 (Iowa 1977) to attempt to argue that discrimination will result if double leverage is not applied. IPL explains that since there is only one other investor-owned electric utility in Iowa which also has a holding company, there would not be discrimination.

Consumer Advocate Initial

Initial Brief: pp. 65-84

To most accurately reflect IPL's true cost of capital, it is necessary to take into account double leverage. Double leverage means that the holding company's common equity investment in its subsidiary is leveraged twice once with the holding company's debt and a second time with the subsidiary's debt. (Tr. 1195-1196)

Because Alliant has both equity and debt as part of its capital structure and IPL also has equity and debt, the existence of double leverage is an observable fact. (Tr. 1196) It is documented in Alliant's accounting and financial statements and in its periodic SEC filings.

The Board has consistently recognized the effects of double leverage when calculating the cost of capital with rare exception. (Consumer Advocate provides an extensive list of references as support on page 66 of its Initial Brief.)

Double Leverage approach has also been a generally accepted ratemaking tool within the U.S. For example, in *General Tel. Co. of the Southeast,* Docket No. U-83-7274, 60 PUR4th 469, 472-473 (Tenn. PSC, February 21, 1984), Consumer Advocate provides the following quote: "at least 21 state commissions have adopted or recognized the validity of the double leverage theory." Many other examples were also listed.

Originally, Consumer Advocate witness Parker proposed that the Board recognize the existence of Alliant's $402.5 million of long-term debt. (Tr. 1195-1196, 1202-1208, 1210-1211; Exh. SJP-1, Sch. A, pp. 1 and 3) This debt was first fully and unconditionally guaranteed by Alliant and ultimately assumed by Alliant in November 2008. (Tr. 1202, 1205)

However, in September 2009 Alliant announced a tender offer to redeem this debt. (Tr. 1251-52; Ex. SJP-3, Sch. C, pp. 1-3 and Sch. D, pp. 1-9) Alliant received consents from the holders that represented 99.96 percent of the outstanding notes or the equivalent of $402.5 million. To pay the tender offer, Alliant announced that it would use cash on hand of $68.8 million and $170

million of borrowings under a term loan facility on September 29, 2009. (Tr. 1252; Exh. SJP-3, Sch. C, pp. 4-6) On October 1, 2009, it submitted its Form 424B5 to the SEC for $250 million of senior notes at the rate of 4 percent to be used to pay of the $170 million in borrowed funds and for general corporate purposes. (Tr. 1254; Ex. SJP-3, Sch. C, pp. 25-76) Due to this issuance, it is indisputable fact that double leverage exists, and it was the financial strength of its utility subsidiaries that helped Alliant to obtain this debt. (Tr. 1202-1203; Exh. SJP-1, Sch. C, pp. 1-2)

Alliant's weighted average cost of capital, using Consumer Advocate's recommended ROE of 10 percent, is 9.517 percent. This is then applied to IPL's common equity ratio as IPL's ROE. The weighted average cost of capital for IPL would then be 8.223 percent. (This overall return is to be applied to IPL's rate base without the Emery plant.) Because the Emery plant was granted a 12.23 percent ROE in IPL's advanced ratemaking principles case, the weighted average cost of capital for this piece is 9.235 percent also reflecting double leverage.

IPL's customers will be overcharged by nearly $8 million annually if the Board ignores the double leverage application in this case. This means that Alliant and IPL would receive a windfall profit. (Tr. 1255; Ex. SJP-3, Sch. B, p. 1)

Consumer Advocate points out that IPL failed to provide the Board with supplement testimony regarding the new capital transactions that occurred in September 2009. However, IPL witness Bacalao, in his rebuttal testimony and at the hearing, made it clear that he opposes accounting for Alliant's new debt issuance in determining IPL's rate of return. He made the following allegations of Consumer Advocate witness Parker's testimony which also applies to all the decisions cited in Consumer Advocate's brief:

1) Ms. Parker's description of the concept of fungibility is incomplete, which compromises her subsequent analysis and conclusions;
2) Her double leverage imputation has no basis and should be disregarded;
3) Alliant's assumption of the Notes has not generated any cash flows that could have been used to fund Alliant's infusions of equity into IPL; and
4) Alliant's assumption of the Notes has not created any liability or obligations for IPL. (Tr. 673-674)

Mr. Bacalao disregards the previous double leverage decisions and the indisputable facts that support the existence of double leverage in IPL's capitalization when he made the statement "[h]er double leverage imputation has no basis."

The fungibility of cash is virtually absolute, and Mr. Bacalao testified that cash is generally fungible. (Tr. 675-676) The rest of Mr. Bacalao's testimony regarding

fungibility of cash is irrelevant and a diversion from the fact that dollars are fungible. (Tr. 676-682) He addresses subjects other than fungibility.

Mr. Bacalao stated that just because both the parent and subsidiary have debt and equity outstanding does not mean that the parent's debt was "automatically" used to invest in the subsidiary's equity. He claims that the Notes assumed by Alliant did not generate any cash flows that could have been used to fund any equity infusions into IPL. (Tr. 674) According to Consumer Advocate, IPL is engaging in tracing. Double leverage does not depend on tracing, and the Board has "disavowed" engaging in tracing. In fact Iowa Electric Light and Power Company, a predecessor of IPL, requested rehearing in Docket No. RPU-91-9, stating that the Board relied on capital tracing to account for double leverage when capital funds are not traceable. The Board explained that its determination that funds are fungible was the basis for its decision.

Therefore, IPL's attempt to trace the use of the funds is both incorrect and irrelevant since capital funds are fungible and become a part of the corporate pot to be used to invest in its subsidiaries' common equity. (Tr. 1201, 1204, 1243) Also there are several ways a parent can invest in its subsidiary such as by leaving retained earnings at the subsidiary level, by purchasing more common stock of the subsidiary, or by providing paid-in capital to the subsidiary. (Tr. 1204-1205) As stated in the Board's Order in *Iowa-American Water Co.*, Docket No. RPU-90-10, *slip op.* at 56 (IUB, Oct. 21, 1991), "The Board . . . will follow its general rule that double leveraging exists when a holding company of a utility has debt in its capital structure."

"The recognition of the $250 million senior notes existing in AEC's capital structure is proper and consistent with the Board's traditional application of double leverage approved by the Supreme Court of Iowa in *United Telephone* and *General Telephone*. The existence of the holding company relationship produces a situation where the subsidiary's capital structure is not truly reflective of the actual debt-equity ratio supporting utility operations. Recognition of and accounting for double leverage adjustment is an attempt to more accurately present the capital structure of IPL and, consequently, an attempt to insure a fair rate of return determination that properly balances the interests of the investors and consumers." (OCA Brief, p. 82)

<u>IPL Reply</u>

Reply Brief: pp. 15-18

Although IPL believes that it has fully briefed this issue, it reiterates why IPL qualifies for an exemption in this case by providing the following information: 1) Alliant's assumption of Alliant Resources debt in November 2008 generated no cash; 2) Alliant's subsequent debt issuance in October 2009 generated no new cash, only replacement cash for that used in the tender offer; and 3) no cash

was, or could have been, infused into IPL by virtue of either above mentioned transactions. (Reply, p. 15) There is no demonstration on how this parent's debt was used to support the utility's capital structure.

Consumer Advocate takes 20 pages of brief to cloud the facts mentioned above. It addresses fungibility, monetary displacement, market competition, comparative calculations, and precedent to support its case and takes the focus away from IPL's specific situation that matches the Board's "narrow exception" to the double leverage application. (OCA Initial, pp. 64-84)

Also Consumer Advocate states that double leverage is "a generally accepted ratemaking tool through the United States." (OCA Initial, p. 66) It also mentions that over 21 state commissions have adopted or recognized the validity of the double leverage theory. However that dates back to 1984. Consumer Advocate failed to provide recent case law that supports this theory. IPL provides seven samples of cases from the years 1980 to 2006 where the double leverage adjustment was rejected (refer to pages 16 to 18 of IPL's Reply Brief) This shows that the double leverage is not a foregone conclusion. In recent years double leverage has come under more scrutiny and been increasingly rejected.

In this case, IPL has demonstrated that neither the November 2008 transaction nor the October 2009 transaction produced funds available for equity infusions into its subsidiaries.

Consumer Advocate Reply

Reply Brief: pp. 16-19

Consumer Advocate is proposing the Board account for the use of double leverage to assure that IPL's rate of return is based on the actual cost of the invested capital. It is not "imputing" double leverage as a form of ring fencing as argued by IPL.

IPL also argues that double leverage is not an appropriate tool if its purpose is to protect the subsidiary from any adverse financial effects resulting from the parent's activities. (Tr. 689) Consumer Advocate explains that double leverage is simply recognizing the capital financing of IPL and Alliant.

The Board, in *Interstate Power and Light Co.,* Docket No. RPU-02-3, "recognizes that there may be appropriate exceptions to the application of double leverage other than one based on the four-factor test the Board has used." IPL believes that the situation presented in this case justifies another exception to double leverage. However, IPL does not explain the exception, but, instead, attempts to use the tracing of dollars to avoid the application of double leverage.

The following testimony by Mr. Bacalao shows how he attempts to trace dollars:

> And if you're curious as to why we used 170 million, it was to make it really clear that Alliant Energy Corporation was not using any money of the utilities in any form or fashion, for example, accrued, advanced payments on tax or anything like that. We just made it really clinically separate. So we borrowed 170, used 68 million of our own money, and then three days later we settled the issuance of the bond. The money came in. We repaid the bridge, and the cash that we could use got repaid out of the cash we received. (Tr. 736-737)

He relies on the impossible distinction between funds transferred to different parts of the company and ignores the fact that funds are fungible.

Lastly, IPL suggests that there is discrimination if Iowa's two rate-regulated electric utilities are not treated the same with respect to the ratemaking treatment of double leverage. Consumer Advocate explains that the other utility's rates are the product of settlements that are not precedent setting. IPL's rates will even be higher relative to the other utility if the Board does not account for double leverage.

Staff Analysis

Proponents of double leverage believe it exists when a holding company has debt and its utility subsidiary has debt as part of their capital structures. The thought behind double leverage is that the parent's capital funds are fungible. One cannot trace what sources of the parent's capital were used to fund the subsidiary's common equity. Therefore, since it is assumed that both debt and equity were used, the parent's overall rate of return is used as the ROE for the utility company. By not allowing the holding company to earn an equity return on its debt capital, this prevents the stockholders from earning a windfall.

There is long history of applying double leverage by the Board and the Iowa Supreme Court affirmed the Board's use of double leverage at least twice. (General Telephone Co. of the Midwest v. Iowa State Commerce Commission 275 N.W.2d 364 (Iowa 1979) and United Telephone Co. v Iowa State Commerce Commission 257 N.W.2d 466 (Iowa 1977)) The Board made a narrow exception to the application of double leverage in an Iowa Electric Light and Power rate case, in Docket No. RPU-89-3, where the Company provided four factors that showed how the parent's debt did not result in an increase in Iowa Electric's common equity. In Docket No. RPU-91-9, one of the factors changed so the Board once again applied double leverage to Iowa Electric. Staff is not aware of any other exception when there is actual debt in the parent's capital structure.

Consumer Advocate provides numerous cites of decisions made by this Board and by the Iowa courts as well as decisions made in other states supporting double leverage within its Initial Brief. When discussing decisions made outside

of Iowa, Consumer Advocate includes the following quote (also provided above) "at least 21 state commissions have adopted or recognized the validity of the double leverage theory." *General Tel. Co. of the Southeast,* Docket No. U-83-7274, 60 PUR4th 469, 472-473 (Tenn. PSC, February 21, 1984) IPL points out that this quote is taken from an order issued in 1984 and notes that all of the cites are dated. Staff agrees that most cites come from decisions made over twenty years ago whereas IPL provides more recent quotes that do not support the use of double leverage in general. This may suggest that the double leverage concept may have been more applicable 20 plus years ago when the holding company concept was simply a holding company with one utility subsidiary. This is rarely the case anymore. Most holding companies have several subsidiaries both regulated and unregulated. With the double leverage concept, the assumption is the weighted cost of capital of the parent would be the ROE for each subsidiary regardless of the risk of each subsidiary.

Consumer Advocate explains in detail that the idea behind the double leverage concept is capital funds are fungible. Funds from the different sources of capital are put into a corporate pot where they can no longer be distinguished from one another. That is why the assumption is made that the parent's funds are applied proportionately to its subsidiaries.

The focus in this case starts with AER's debt issue that Alliant fully and unconditionally guaranteed back in 2000. In Docket No. RPU-02-3, Consumer Advocate proposed including this debt issue as part of Alliant's capital structure and then applied double leverage, because Alliant guaranteed this debt. However, the Board denied Consumer Advocate's proposed adjustment because the evidence showed that none of the proceeds from that debt could have been used to support the equity in either of its utility subsidiaries. More specifically it stated:

> Consumer Advocate in its double leverage adjustment not only included the $24 million debt issue but also included Alliant Resources's debt that is guaranteed by Alliant. This is a non-traditional use of double leverage and is contrary to the premise that the parent issues debt in order to infuse equity into a utility subsidiary. (Tr. 1610, 1699-1700) Alliant Resources is the non-regulated subsidiary of Alliant, IPL's parent. Alliant Resources's debt is kept separate from IPL and has not been used to infuse equity into IPL. Each company issues its own debt to fund its own operations. Consumer Advocate admitted that Alliant cannot use the proceeds from Alliant Resources's debt issues. (Tr. 2099-2101) While Alliant has fully and unconditionally guaranteed Alliant Resources's debt, IPL is not responsible for paying the debt if there is a default and none of its assets were pledged as collateral for the debt. Alliant Energy can use any source of funds it has to pay the debt in the event of a default, such as dividends or the issuance of equity or debt. IPL noted that it has several restrictions on its bonds and equity ratios such that it is unlikely that IPL could be a

> significant source of money for Alliant Energy to repay the debt. (Tr. 1701-1701A) Even if Alliant Energy wanted to sell some or all of IPL's assets to pay the debt, Board approval would be required pursuant to Iowa's reorganization statutes, Iowa Code §§ 476.76 and 476.77. Most importantly, the proceeds from the debt were not used to invest in the common equity of IPL or any other subsidiary, so the underlying theory behind a double leverage adjustment is not present.
> (Final Decision and Order, issued April 15, 2003, pp. 59-60)

In this case, Alliant assumed AER's debt in November 2008, as part of its response to the Notice of Default dated September 4, 2008. This meant this debt was included in Alliant's books and was a part of its capital structure. Consumer Advocate argued that as long as this debt issue was reflected in Alliant's balance sheet, double leverage existed as a matter fact. Even though there has not been a direct equity infusion in IPL as a result of issuing this debt, it became a part of the pool of funds (which are fungible) that were available to be used for other purposes. Additionally, it claimed that Alliant's investment into the utility subsidiaries' common equity was "effectively" used as collateral for this debt.

Again, in its testimony, IPL provided much of the same evidence presented in Docket Nos. RPU-02-3 and RPU-02-7 in this case. IPL explained that the court cases cited by Consumer Advocate show that double leverage does not apply in this case. AER issued this debt in 2000 to be used for the unregulated subsidiary. Although Alliant guaranteed this debt, the funds were never available for Alliant to use. Therefore, these funds were never used to fund equity infusions into any of its subsidiaries. IPL also states that IPL is not impacted by the debt issuance, its assets were not pledged to support AER's debt and it has no impact on its customers. The funds needed to pay back principle and to pay interest would come from AER.

Most currently, AER's Notes assumed by Alliant have mostly been replaced by new debt issued by Alliant. As mentioned above, in September 2009, Alliant extended a tender offer with a deadline of September 28, 2009, and holders tendered 99.96 percent of the notes. Initially, Alliant used $68.8 million of cash on hand and drew down a three-day $170 million bridge loan. (Tr. 736-737, Tr. 1253) It made a SEC filing on October 1, 2009, regarding a $250 million, five-year debt issue with a coupon rate of 4 percent to repay the bridge loan and to pay the additional expenses. (Tr. 735-736) Therefore, Consumer Advocate filed supplemental testimony reflecting this transaction. It chose to replace the $402.5 million of old AER debt in Alliant's capital structure with Alliant's new debt that was issued in early October 2009.

Because both the Iowa Supreme Court and the Board has stated the utility can provide evidence to show how the double leverage is not applicable in its case, in general a utility works hard to demonstrate how the proceeds from a debt

issuance at the parent level could not have been infused in the utility. This case is no different.

Referencing language from a previous Board order where the Board stated it would not mechanically apply double leverage but instead review evidence presented in each case, IPL is now providing evidence showing how this new debt issuance could not have resulted in an increase in IPL's common equity.

More specifically, in Docket No. RPU-02-3, the Board made the following statement:

> The Board sees no reason on this record to disavow the application of double leverage in all instances. Double leverage is one regulatory tool to help protect the utility from abuse by its parent company. The Board understands the complex nature of these relationships and transactions and will not apply double leverage mechanically in each case, but rather will examine the particular facts and circumstances in each case where the adjustment is proposed.

In summary, IPL states that this transaction ended up being a "zero-sum process." No cash was available to invest in IPL's common equity. Given the evidence, IPL believes no double leverage adjustment is needed.

As quoted above, the Board stated, "Most importantly, the proceeds from the debt were not used to invest in the common equity of IPL or any other subsidiary, so the underlying theory behind a double leverage adjustment is not present." This holds true in this case as well. Given the timing of the issue (i.e., October 2009), which is even beyond the nine month window allowed in the above mentioned legislative language, the equity infusions in IPL occurred before the issuance of the new debt. Staff would note that in future rate cases, if there is an equity infusion made after the date of new debt issuance, then consistent with past Board precedent, the Board would once again apply double leverage. In Docket Nos. RPU-91-9, RPU-02-3, and RPU-02-7, the Board recognized a post-test year equity infusion to justify applying double leverage even though the utility stated that none of the proceeds were used to invest in the utility company.

Recommendation: Double leverage should not be applied in this case based on the evidence provided by IPL.

Rate Design / Class Cost of Service

Design of Base Rates

IPL Initial

> Initial Brief: pp. 120-21

IPL is proposing a uniform across-the-board percentage adjustment for allocating its proposed revenue increase among customer classes. Within each customer class, this uniform percentage increase is applied to each rate classification, regardless of pricing zone, excluding the revenue associated with the Energy Cost Adjustment (EAC), Energy Efficiency Cost Recovery and excess facilities charges.[41] The uniform percentage adjustment does not apply to customer charges, because customer charges are being addressed through the rate equalization process.[42]

Consumer Advocate Initial

Initial Brief: pp. 109

Regardless of the Board's final determination of the revenue requirement, IPL, Consumer Advocate, and ICC agree that the increase or decrease in rates should be a uniform percentage change in the rates per kW and the rates per kWh, with a few exceptions for some rate design changes.[43] (Tr. 754-55, 849-50, 1266, 1268, 1278-79, 1282-83, 1288, 1300).

ICC Initial

Initial Brief: p. 63

In accordance with IPL's proposal, any increase in IPL revenues should be distributed on a uniform percentage basis.

LEG Initial

Initial Brief: p. 16

LEG endorses IPL's CCS study, with three modifications, and recommends the Board to use the modified study as the basis for allocating IPL's revenue requirement among customer classes. (Tr. 1362, 1365-66).

AGP Initial

Initial Brief: p. 8

[41] IPL Exhibit DV-1, Schedule A shows the percentage increases for each customer class, by pricing zone. (Tr. 753).

[42] That is, the rate equalization process approved in the Board's April 30, 2006, Order in Docket No. RPU-05-3. (Tr. 754).

[43] Consumer Advocate does not dispute IPL's proposed rate design changes.

AGP supports LEG's position.

Staff Analysis

IPL's method for adjusting class base rate revenues seems to have the side effect of altering IPL's class rate designs, with potentially significant billing impacts for some customers.

IPL's method: 1) determines the revenue increase for each customer class based on the uniform percentage adjustment factor; 2) by rate zone, subtracts each customer class subgroup's Rider RTS transmission revenue; then 3) determines the uniform percentage increase for the class subgroup's base rate elements that will bring about the remaining revenue increase. The problem with this approach is that when the Rider RTS class transmission rates are added to the corresponding class base rate elements (which is how customers will experience them in terms of billing impact), the resulting combined percentage increases will NOT necessarily be uniform; and, in some cases, will vary by a wide margin. Alternatively, this potential problem can be corrected by FIRST adjusting class base rate elements by a uniform percentage, and THEN subtracting the Rider RTS class transmission rates from the corresponding class base rate elements.

The following provides a detailed illustrative explanation of IPL's uniform percentage increase method, compared to the alternative method suggested above. This comparison is based on IPL's proposed final increase for Residential rates in the IES-S zone (not including time-of-use customers), shown in Exhibit DV-1, Schedule C (sheets labeled "IES Utilities, Inc."), page 1.

Again, IPL's method deducts Regional Transmission Service (Rider RTS) revenue first, BEFORE applying the uniform percentage adjustment to volumetric base rates. This effectively deducts the RTS revenue from volumetric base rates on a PROPORTIONAL basis (i.e., when the RTS revenue is deducted first, before applying the uniform percentage, it effectively reduces the uniform percentage adjustment from 28.7% to 4.8%). **However, the RTS rate is charged as a FLAT RATE (1.386¢ per kWh) rather than proportionally on a uniform percentage basis**. Thus, when the flat RTS rate is combined with the volumetric base rates for billing purposes, the combined percentage impact is not uniform, but varies across individual volumetric rate elements (**thus altering the rate design**), as follows:

	2008 Volumetric Rates	Plus Uniform 4.8% Increase	Plus Flat 1.386¢/kWh RTS Rate	Combined Percentage Increases
SUMMER				
First 500 kWh	$0.07930	$0.08314	$0.09700	22.3%
Next 700 kWh	$0.07586	$0.07952	$0.09338	23.1%
Over 1200 kWh	$0.06926	$0.07261	$0.08647	24.8%
WINTER				
First 500 kWh	$0.06520	$0.06836	$0.08222	26.1%
Next 700 kWh	$0.04839	$0.05074	$0.06460	33.5%
Over 1200 kWh	$0.02570	$0.02694	$0.04080	58.8%

Again, staff's alternative method applies the full uniform percentage increase FIRST (i.e., 28.7%), and THEN deduct RTS revenue from volumetric base rates in the form of a flat rate (i.e., 1.386¢/kWh, the same way it is charged to customers). That way, when the flat RTS rate is added to the volumetric base rates for billing purposes, the combined percentage impact is uniform across individual volumetric rate elements, as follows:

	2008 Volumetric Rates	Plus Uniform 28.7% Increase	Deduct RTS Revenue (1.386¢/kWh)	Plus Flat 1.386¢/kWh RTS Rate	Combined Percentage Increases
SUMMER					
First 500 kWh	$0.07930	$0.10205	$0.08819	$0.10205	28.7%
Next 700 kWh	$0.07586	$0.09762	$0.08376	$0.09762	28.7%
Over 1200 kWh	$0.06926	$0.08913	$0.07527	$0.08913	28.7%
WINTER					
First 500 kWh	$0.06520	$0.08390	$0.07004	$0.08390	28.7%
Next 700 kWh	$0.04839	$0.06227	$0.04841	$0.06227	28.7%
Over 1200 kWh	$0.02570	$0.03307	$0.01921	$0.03307	28.7%

Staff's alternative method would ensure that the initial implementation of Rider RTS is rate design neutral. It would also ensure that final rate design billing impacts are the same, whether Rider RTS is implemented or not. At the hearing, IPL indicated it had not considered this alternative method for making uniform percentage adjustments. (Tr. 820-21).

Staff recommends the Board approve IPL's basic proposal to increase base rates by a uniform percentage, based on its final revenue requirement.

However, staff also recommends the Board adopt Staff's alternative method for making the uniform percentage adjustments.

The Board should also clarify that after initial implementation, Rider RTS (if approved) will thereafter be adjusted independently, apart from base rates – similar to adjustments for the energy adjustment clause (EAC), energy efficiency cost recovery (EECR), and interruptible credits.

Class Cost of Service

IPL Initial

Initial Brief: pp. 120-23

Although IPL has conducted a class cost-of-service (CCS) study, IPL recommends that the results of the study not be implemented in this proceeding. IPL filed its CCS study for informational purposes only, and has not based its proposed revenue allocation on the results of the study. IPL instead proposes using a uniform across-the-board percentage for allocating its proposed revenue increase among customer classes.

As part of its rate equalization plan, IPL outlined a process in Docket No. RPU-04-1 that would not shift revenues among customer classes based on a CCS study until rates had been fully equalized. Since the rate equalization process will not be completed by the conclusion of this proceeding, IPL recommends the Board not use the results from the CCS study to allocate the final revenue increase among customer classes. (Tr. 754).

IPL states its position is consistent with what the Board has approved in previous proceedings.[44] Also, both Consumer Advocate (Tr. 850, 1266) and ICC (Tr. 1300) have generally accepted IPL's proposed uniform percentage revenue adjustment among customer classes. IPL proposes to review and address any CCS issues after the rate equalization and tariff consolidation process has been concluded. (Tr. 792).

IPL asserts it is premature to litigate CCS issues in this case, since IPL's proposed final rates are not based upon the results of a CCS study. Consumer Advocate witness Wilson's rebuttal testimony illustrates possible approaches for changing IPL's allocation methodologies; but Consumer Advocate is not proposing an alternative CCS study at this time. (Tr. 1276). LEG proposes changes, but has not provided an alternative CCS study based on its changes for review in this proceeding. (Tr. 793). There is no evidence in the record that shows the customer impacts of the alternative cost allocation methods suggested by any of the intervening parties.

[44] See Docket No. RPU-04-1, Final Order, p. 40; and Docket No. RPU-05-3, Final Order, p. 36.

Consumer Advocate Initial

Initial Brief: pp. 109-10

LEG proposes that rate changes in this case should be based on the CCS study prepared by IPL, with three significant changes to the cost allocation methodology. (Tr. 1359-60, 1362-66). However, LEG agrees that IPL should adjust its base rates by a uniform percentage if the Board does not adopt a CCS study in this proceeding. (Tr. 1366).

The Board initiated an intended 5-year revenue-neutral rate equalization process in Docket No. RPU-04-1.[45] In subsequent proceedings, the Board made it clear that it would not base its determination of IPL' s rates on any CCS study until the rate equalization process was complete.[46] IPL has not completed its rate equalization process. (Tr. 243, 754, 849-50). On May 26, 2009, the Board granted IPL's motion to delay implementation of the fourth step of its rate equalization.[47] On July 6, IPL filed revised tariffs to implement the fourth step.

The Board should not apply the results of IPL's CCS study, or any other CCS study (either with or without the modifications proposed by LEG). Instead, the Board should adopt IPL's uniform percentage adjustment approach.

ICC Initial

Initial Brief: pp. 63-64

In accordance with IPL's proposal, any increase in IPL rate revenues should be distributed on a uniform percentage basis. Along with the reasons advanced by IPL, it would be too speculative, unreliable, and inherently unfair to adopt a class cost allocation based on the CCS study filed by IPL in this proceeding (which was filed for informational purposes only). It would be more reasonable to wait until rate equalization is completed before taking on the likely contentious issues associated with changing class allocations based on a new CCS study. This case presents sufficiently complex and disputed issues without having to address CCS. The fact that IPL, Consumer Advocate, and ICC have all agreed that CCS should not be addressed lends considerable support for deferring CCS issues.

[45] See Interstate Power and Light Co., Docket No. RPU-04-1, slip op. at 21-27 (IUB, Jan. 14, 2005).

[46] See Interstate Power and Light Co., Docket No. RPU-05-3, slip op. at 2-3, 5, 11 (IUB, Apl. 28, 2006) and slip op. at 7-8, (IUB, Jun. 7, 2006) (Order on Rehearing).

[47] See Interstate Power and Light Co., Docket No. RPU-08-5, slip op. at 3 (IUB, May 26, 2009).

Regarding IPL's CCS study, ICC notes that IPL calculates its Bulk Power class tariff revenues with the assumption that part of the load will be interruptible, but it does not add back the interruptible credits associated with these Bulk Power customers in determining the cost of service for the Bulk Power class. As ICC's witness testified, this oversight results in an approximate $5 million per year overstatement of cost of service for the Bulk Power class. (Tr. 1301). This testimony is un-rebutted. (Tr. 793, 816). Accordingly, any increase in revenues should be distributed on a uniform percentage basis, with interruptible credits credited back to the Bulk Power class.

LEG Initial

Initial Brief: pp. 13-18

A primary focus of LEG in this docket is to ensure that final rates approved by the Board are based on customer CCS with no subsidies among customer classes. (Tr. 1359). This focus is firmly rooted in the established law governing electric utility rate design and class cost allocation.

The Board's rules establish mandatory rate design and cost study requirements applicable to electric rates subject to the Board's regulatory jurisdiction. (199 IAC 20.10). The first paragraph of subrule 20.10(2) establishes the following general principle:

> **Rates charged by an electric utility for providing electric service to each class of electric consumers shall be designed, to the maximum extent practicable, to reasonably reflect the costs of providing electric service to the class**. The methods used to determine class costs of service shall to the maximum extent practical permit identification of differences in cost-incurrence, for each class of electric consumers, attributable to daily and seasonal time of use of service, and permit identification of differences in cost-incurrence attributable to differences in demand, energy, and customer components of cost. (Emphasis added).

The subrule then goes on to establish guidelines for evaluating the acceptability of methods of CCS determination.

Subrule 20.10(2) was promulgated by the Board pursuant to federal law; specifically, the Public Utility Regulatory Policies Act of 1978 (PURPA). PURPA required each state regulatory authority to consider and, if deemed appropriate by such authority, adopt certain federal ratemaking and cost-of-service standards applicable to rate-regulated electric utilities. (16 U.S.C. §§ 2621, 2625(a)). The ratemaking standards in subrule 20.10(2) were adopted by the Board at the conclusion of a rulemaking proceeding (Docket No. RMU-80-1) conducted to

discharge the Board's PURPA obligations.[48] The three goals of the PURPA rate design standards are: (1) conservation of energy supplied by electric utilities; (2) the optimization of the efficiency of use of facilities and resources of electric utilities; and (3) equitable rates to electric consumers.[49] At the time subrule 20.10(2) was adopted, the Board found that all three PURPA goals were furthered by the rule.[50] With respect to the specific goal of equitable rates to electric consumers, the Board observed in its order adopting subrule 20.10(2):

> The final goal of PURPA requires that rates to electric consumers be equitable. Although we acknowledge that equity is a subjective criterion, we believe that at heart, equitable electric rates require that customers who impose the same costs on the utility system be treated in the same manner. This is the final goal of cost-based rates.... The entire thrust of the rules we adopt today is to **guarantee that each customer fairly pays the appropriate share of the costs of providing electricity which are associated with that customer's use**. Since we believe that **this concept is the most important element in equitable electric rates**, we conclude that the rules we adopt today also further the third goal found in PURPA.[51] (Emphasis added).

Elsewhere in its order, the Board stated:

> There seems to be a general belief by all customer classes [demonstrated in the record of the rulemaking proceeding] that they are bearing costs which other customer classes cause the utility to incur. Such a situation would be both **inequitable and inefficient**, and should be **avoided to the maximum extent possible**. (Emphasis added).

The key role in ratemaking played by cost-based rates has been more recently described by the Board as follows:

> Cost-based rates promote earnings stability for the utility and provide a more reliable basis for determining future levels of energy costs for the customers. Cost-based rates promote energy efficiency by sending customers accurate price signals and place

[48] "Order Adopting Rules and Statement of Reasons for Adoption of Rules Pursuant to Section 17A.4(1)b," In re Rules Requiring the Filing of Certain "Cost of Service" Information with the Iowa State Commerce Commission, Docket No. RMU-80-1 (ISCC July 6, 1981).

[49] Id. at 31-32.

[50] Id. at 32-33.

[51] Id. at 33.

> Iowa utilities in a better position to deal with...national market changes.[52]

Not only do cost-based rates send correct price signals to customers, they also reduce "any potential for cross-class subsidization."[53]

IPL's initial filing in this docket included a CCS study.[54] (Tr. 750, 779-787; Ex. DV-1, Sch. I). No other party submitted a CCS study. (Tr. 793, 1279). Thus, IPL's study is the only CCS study in the record. However, IPL has chosen not to use its study for the purpose of allocating its revenue requirement among customer classes, but instead has elected to allocate its revenue requirement on a "uniform across-the-board percentage" basis. (Tr. 753, 780, 787, 793). Consequently, LEG argues the class rates proposed by IPL do NOT reasonably reflect the costs of providing electric service to the classes.

LEG proposes three modifications to IPL's CCS study; and urges the Board to use the modified study as the basis for allocating IPL's revenue requirement to IPL's customer classes. (Tr. 1362, 1365-1366). The exceptions and appropriate modifications are as follows:

(1) The Average and Excess Demand (AED) used to allocated generation costs in IPL's CCS study should be modified to exclude interruptible load from peak demand. (Tr. 1364). IPL's CCS study allocates generation costs on the basis of a hypothetical peak demand estimate of class demand that includes interruptible loads. This approach ignores the fact that interruptible load is not contributing to firm peak demand, which is the basis for additional generation capacity.

(2) The AED in IPL's study should be further modified to remove the Lighting class from the allocation of peak generation costs because of the primarily off-peak nature of Lighting usage. IPL's CCS study treats the Lighting customer class as if the peak for the class occurs in the afternoon at the time of IPL's coincident peak. This totally unrealistic assumption results in the unreasonable and unfair allocation of a significant portion of generation costs to the Lighting class. (Tr. 1364-65). As a result, municipalities, including one of LEG's members (the City of Cedar Rapids), pay Lighting rates that are significantly higher than their cost of service.

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[52] "Final Decision and Order," In re Interstate Power Co., Docket No. RPU-92-10, at p. 6 (IUB May 26, 1993).

[53] "Final Decision and Order," In re Interstate Power and Light Co., Docket No. RPU-02-3, RPU-02-8, ARU-02-1, at 64 (IUB Apr. 15, 2003).

[54] No other party submitted a CCS study. (Tr. 793, 1279). IPL's study is the only CCS study in the record.

(3) LEG prefers that IPL continue using the AED method (excluding interruptible and Lighting peak loads) for allocating transmission costs as it has in past cases, rather than using the twelve monthly coincident peaks (12-CP) proposed in this case. However, LEG does recognize that MISO allocates its monthly transmission charges on the basis of monthly coincident peaks (Tr. 784, 1363), and for that reason would not object if the Board were to approve the 12-CP method for allocating transmission costs. (Tr. 1414).

IPL's rates were last based on a CCS study in IPL's 2002-03 rate case, Docket No. RPU-02-3. (Tr. 808). In every subsequent IPL rate case since then, IPL's revenue requirement has been allocated to rate classes on a uniform percentage basis rather than by a CCS study. (Tr. 808-09). There is no basis for believing that the rates currently in effect or proposed by IPL in this docket bear any reasonable relationship to IPL's CCS study as modified by LEG. IPL's proposed rates are inherently inequitable and create cross-subsidies among classes. Accordingly, the Board should require IPL to allocate its revenue requirement among customer classes based on IPL's CCS study as modified by LEG. (Tr. 1365-66, 1391).

AGP Initial

Initial Brief: p. 8

AGP supports LEG's position on this issue.

IPL Reply

Reply Brief: p. 37

IPL is confused by ICC's discussion about the treatment of interruptible credits for the Bulk Power class. To clarify IPL's position, IPL agrees that the CCS study should reflect the proper crediting of interruptible credits to the Bulk Power class. However, since IPL does not propose using the CCS study for cost allocation purposes, it has no relevance in this proceeding.

Consumer Advocate Reply

Reply Brief: p. 24

The Board has made it clear that it would not use any CCS study to prescribe IPL's rates until the rate equalization process initiated in 2005 is complete.[55] IPL has not completed its rate equalization process. (Tr. 243, 754, 849-50). Thus,

[55] Interstate Power and Light Co., Docket No. RPU-05-2, slip op. at 2-3, 5, 11 (IUB, Apr. 28, 2006) and slip op. at 7-8, (IUB, Jun. 7, 2006) (Order on Rehearing).

the Board should not rely on any CCS study in its determination of IPL's rates in this case.

ICC Reply

Reply Brief: p. 23

ICC stands on its Initial Brief on this issue. The use of a CCS study should be deferred until after rate equalization is complete.

LEG Reply

Reply Brief: pp. 12-16

Only AGP agrees with LEG's position that IPL's revenue requirement should be allocated to customer classes on a CCS basis rather than a uniform percentage basis. None of the parties opposing LEG's position, however, addresses the ratemaking standards established by the Board's rules and discussed at length in LEG's initial brief.[56] Only LEG's proposal to use an appropriately modified version of IPL's CCS study comports with those ratemaking standards; and IPL's CCS study is the only study in the record.[57] The uniform percentage allocation supported by IPL, Consumer Advocate, and ICC does not reasonably reflect the costs of providing electric service to each class and, thus, is inherently inequitable and creates cross-subsidies among classes.

It has been 6 years since the 2003 implementation of rates approved in Docket No. RPU-02-3, when IPL's rates last reflected a cost-based allocation of IPL's revenue requirement. (Tr. 808-09). IPL does not plan to propose a CCS-based allocation of its revenue requirement in the rate case it will file in March 2010, because rate equalization will not have been accomplished until later in 2010 and possibly even later than that. (Tr. 132, 290-91). When asked whether IPL plans to file a rate case in 2011, IPL witness Madsen answered, "At this point I hope not." (Tr. 292). Assuming that IPL files a rate case in 2012 and rate equalization has been completed, the earliest time at which IPL's rates would reflect a cost-based allocation would be four years from now, in 2013. This means that for a period of ten years – from 2003 to 2013 – IPL's rates will not have been based on a CCS study.

IPL and Consumer Advocate offer the same rationale for rejecting a cost-based allocation of IPL's revenue requirement in this case; namely, that the rate-

[56] LEG Initial Brief, pp. 13-16.

[57] Although Consumer Advocate witness Wilson testified at length about the CCS study methodology he prefers, he admitted during cross-examination that Consumer Advocate is not recommending any changes or adjustments to IPL's CCS methodology at this time. (Tr. 1279, 1282).

equalization process initiated in Docket No. RPU-05-3 was incomplete. However, at the time of the Board's RPU-05-3 decision in 2006, it was assumed that the rate equalization process would be complete in four more years, at which time CCS revenue realignments would be addressed.[58] However, as demonstrated above, at the earliest it will be four more years (2013) before IPL's rates will be based on CCS. This significant change in circumstances warrants a different decision on class allocation methodology from the one the Board reached in Docket No. RPU-05-3.

IPL and ICC also contend that it is "premature" to litigate CCS issues because IPL has not proposed using its CCS study to set final rates. However, this contention is contradicted by one of IPL's own witnesses, who testified that while IPL does not intend to propose any CCS changes in its next rate case, "it doesn't prevent other parties from making that proposal to adjust rates based on a class cost-of-service study, nor does it prevent the Board from making those types of adjustments." (Tr. 291-92).

ICC asserts that it would be "too speculative, unreliable, and inherently unfair" to use IPL's CCS study, but fails to provide any explanation or support for that assertion. ICC then alleges that it would be more prudent to wait for the completion of the rate-equalization process before taking on the likely-contentious issues associated with changing allocations based on a new CCS study. The allocation issues are as likely to be contentious in a future rate case as they are now, and ICC has not provided any real justification for waiting, nor explained why it would be more prudent to address those issues in a future rate case. Although ICC does go on to claim that this case presents sufficiently complex and disputed issues without having to address CCS, ICC has offered no reason to believe that the next rate case will not present issues of at least the same degree of complexity and contentiousness.

An additional reason for ICC's endorsement of a uniform across-the-board allocation of IPL's revenue requirement is uncertainty about whether Large General Service customers will transfer to the Bulk Power class, and about what their load profiles will be following the transfer. (Tr. 1300-01). However, this position is inconsistent with ICC's subsequent testimony at the hearing (Tr. 1322):

> Q. At the bottom of page 11 of his testimony, Mr. Vognsen focuses on short-term changes. Is it appropriate to maintain an existing rate design solely on the basis of short-term impacts?
>
> A. No. Rates should be designed appropriately to reflect cost of service. Cost of service is based on fundamental cost-

[58] "Final Decision and Order," In re Interstate Power and Light Company, Docket No. RPU-05-3, at 4, 6, 10-11 (IUB Apr. 28, 2006).

> causation principles and deciding whether or not to adopt a particular rate design methodology should not hinge upon short-term impacts. What is more important is that the long-term consequences be allowed to occur. Under Mr. Vognsen's short-term focus, it would be difficult ever to make any changes in rate design.

Yet, contrary to this, ICC argues that the short-term impacts of transfers from one rate class to another and the potential changes in customer load profiles [59] are reasons for maintaining an existing rate design.

Staff Analysis

The Board previously decided not to shift customer class revenue requirements based on the CCS studies presented in Docket Nos. RPU-04-1 and RPU-05-3, prior to completion of the IPL rate equalization process. The purpose of this was to avoid compounding equalization increases with increases from class cost realignments. Step 4 of the 5-step equalization process was implemented on September 16, 2009. Step 5 is expected to be filed next year, and its impacts will probably interact with IPL's anticipated 2010 rate case, as Step 4 has with the current proceeding.

LEG notes that none of the parties opposing LEG's position address the ratemaking standards in the Board's rules, as discussed in LEG's initial brief. This might be because the Board's ratemaking standards in rule 199 IAC 20.10 were previously addressed in the earlier stages of the rate equalization process, in Docket Nos. RPU-04-1 and RPU-05-3. In those dockets, many of the same arguments with respect to rule 199 IAC 20.10 made by LEG in this proceeding were made by LEG's associated organization, the Community Coalition for Rate Fairness (CCRF). (Tr. 1364). In addressing this issue in Docket No. RPU-04-1, the Board stated:

> Class cost-of-service studies are a useful guide in setting rates, but such studies are not the only consideration in setting just and reasonable rates. Subrule 199 IAC 20.10(1) allows the Board to waive strict adherence to its ratemaking standards and the Board's rules do not specifically require a utility to file a new class cost-of-service study if there are no proposed changes in rate design. (Docket No. RPU-04-1, Final Decision and Order, January 14, 2005, p. 17).

Again, in Docket No. RPU-05-3, the Board stated:

[59] At the hearing, ICC agreed that as a general proposition it is not uncommon for customers to change rate classes between rate cases, nor uncommon for customers who change rate classes to also change their load profiles. (Tr. 1331).

> The Board continues to believe that the class revenue relationships established in Docket No. RPU-04-1 should be preserved to avoid combining the rate impacts from potential inter-class revenue shifts and intra-class rate equalization. The principle of cost-based rates must be balanced with other ratemaking principles, such as the avoidance of unnecessary rate shock. CCRF has not persuaded the Board that the issues related to class cost-of-service and the baseline assumptions from Docket No. RPU-04-1 should be relitigated in this proceeding. (Docket No. RPU-05-3, Final Decision and Order, April 28, 2006, p. 11).

IPL, Consumer Advocate, and ICC have adhered to the Board's previous decisions in RPU-04-1 and RPU-05-3, and have advocated no changes in CCS allocation. Thus, competing CCS positions have not been fully developed in this case. A full litigation of CCS issues might have led to the fuller development of alternative class allocation methods by other parties, which might have been significantly different from those proposed by LEG.[60] The modifications to IPL's AED allocation method proposed by LEG (i.e., excluding interruptible load from peak demand, and removing the Lighting class from the allocation of peak generation costs) were unsuccessfully sponsored in previous IPL rate cases; and the impacts of these changes on IPL's CCS study results in this case have not been presented.

Also, as noted by ICC, significant changes are taking place in the Bulk Power class, which might make it premature to implement CCS changes before the full impacts of these changes are known. The most important of these changes extend the availability of Bulk Power to IPL's other pricing zones for the first time, which will significantly increase the number of Bulk Power customers. (Tr. 1300-01).

IPL's unadjusted informational CCS study suggests lower than average increases in General Service and Lighting class revenue requirements (i.e., 11.5 percent compared to 19.4 percent overall), and a significantly higher than average increase (34.7 percent) for the Bulk Power class. (Exhibit DV-1, Schedule I, page 8, line 27).

Staff recommends the Board continue its previous practice of not implementing CCS revenue requirement shifts among customer classes until the IPL rate equalization process is completed, especially given the lack of a full record on competing CCS methods and their potential class impacts, and

[60] The rebuttal of LEG's proposed CCS modifications by Consumer Advocate witness Wilson suggests that Consumer Advocate would have argued for a significantly different methodology than LEG. (Tr. 1266-76).

given the potential instability of the Bulk Power class due to a significant change in its eligibility requirements.

Design of Regional Transmission Service Clause (Rider RTS)

IPL Initial

Initial Brief: pp. 110-11

IPL proposes to allocate its annual transmission expense to customer classes based on the Average and Excess Demand (AED) allocation methodology, which is consistent with how transmission expense has historically been reflected in base rates. By allocating according to this methodology, there will be no shift in transmission cost responsibility among customer classes.

The Rider RTS factors will be revised annually similar to the Energy Efficiency Cost Recovery factors. IPL will file its revised Rider RTS factors in November of each year going forward, to become effective in January for the next year. The revised factors will include a true-up based on 12 calendar months of actual data from November of the prior year through October of the current year, reconciling the actual transmission costs attributable to the Iowa retail jurisdiction with the actual cost recovery from the rider. The refunds related to the Alternative Transaction Adjustment (ATA) from Docket No. SPU-07-11 will be passed through as a reduction to the transmission expense projections. (Tr. 767).

Consumer Advocate Initial

Initial Brief: p. 109

Consumer Advocate does not dispute IPL's proposed rate design changes.

ICC Initial

Initial Brief: p. 64

The proposed rider should be rejected, and the proposed RTS transmission cost recovery components for the Large General Service (LGS) and Bulk Power classes should be re-combined with the LGS and Bulk Power base rate demand charges.

LEG Initial

Initial Brief: pp. 10-11

If the Board decides to approve IPL's proposed Rider RTS automatic adjustment mechanism, the per-kW demand charges should be cost-based by voltage

delivery level. IPL proposes to develop the Rider RTS transmission adjustment factor for the LGS class by reducing LGS base rate demand charges to remove estimated transmission costs from existing base rates, and replacing this with a separate $3.92/kW Rider RTS adjustment factor for the LGS class. However, this could result in an inadvertent rate increase for LGS customers that currently benefit from primary service discounts (ranging from 4.42 percent to 10 percent depending on delivery voltage level). By removing transmission costs from existing base rates and transferring them to the Rider RTS adjustment factor, LGS primary service customers could lose their primary service discounts on the portion of demand charges removed from base rates. (Tr. 1375). This problem can be solved by including the LGS primary service discount in the Rider RTS tariff as well. (Tr. 1375; Ex. RJL-1, Sch. 4). IPL appeared to agree to this solution during the hearing. (Tr. 813-15).

IPL Reply

Reply Brief: p. 37

Consistent with the commitment IPL made during the hearing, IPL will add the following language to the bottom of the RTS Rider Tariff Sheet No. 86: "* Large General Service RTS charges shall be included with base rate demand charges in the application of primary service and power factor provisions of the Large General Service tariff."

Staff Analysis

Apart from the issue of whether there should even be a Rider RTS, **the issue of Rider RTS rate design seems resolved**.

If the Board adopts IPL's proposal for an RTS adjustment clause, it should confirm that it expects IPL to add its proposed additional language to its Rider RTS compliance tariff:

> *** Large General Service RTS charges shall be included with base rate demand charges in the application of primary service and power factor provisions of the Large General Service tariff.**

Large General Service (LGS) Tariff Changes

IPL Initial

Initial Brief: pp. 126-127

LEG raises an issue over a proposed change for the primary service discount provision, regarding the eligibility of the 4.42 percent primary service discount, and proposes alternative language that would insert the words “less than” in the following phrase: “4.42% for 4,160 volts to less than 34,500 volts.” (Tr. 1376).

Consumer Advocate Initial

Initial Brief: p. 109

Consumer Advocate does not dispute IPL’s proposed rate design changes.

ICC Initial

Initial Brief: p. 64

IPL’s tariff and rate design proposals for the LGS class are generally appropriate, except for creation of the Regional Transmission Service (RTS) rider.

LEG Initial

Initial Brief: pp. 25-27

IPL has proposed a change to the primary service discount section of the LGS tariff. The purpose of the change is to extend primary service discounts to all customers that receive voltage at 34.5 kV, and not only to 34.5 kV customers “in those locations where [the] 34,500 volt system functions as transmission.” (Tr. 771). This change reflects the fact that essentially all of the 34.5 kV system has been conveyed to ITC-Midwest, and is now transmission by definition. (Tr. 771). LEG supports this proposed change, subject to the following correction. The eligibility requirement for the 4.42 percent primary service discount should be amended from “4,160 to 34,500 volt service” to “4,160 to less than 34,500 volt service.” This is necessary to ensure that customers with 34,500 volt service will unambiguously qualify for the 7.5 percent primary service discount, which applies to “69,000 and 34,500 volt service,” rather than the 4.42 percent discount. (Tr. 1376-1377; Ex. RJL-2, Sch. 2). IPL agrees that the modification is appropriate. (Tr. 794).

In its initial written testimony, LEG had proposed an additional modification, deleting what at the time seemed to be a redundant clause in the primary discount section. (Tr. 1377). However, during the hearing, IPL explained its reasoning for keeping the clause in greater detail. (Tr. 809-11). In light of this additional explanation, and the fact that redundancy is not a material failing in a tariff (especially when it is intended to provide additional clarification to customers), LEG withdraws its second proposed modification.

Staff Analysis

IPL proposes two changes in its LGS Tariff.[61] **Aside from LEG's proposed wording modification (which IPL does not oppose), none of the parties oppose these LGS tariff changes**.

IPL agrees to LEG's first wording modification (i.e., inserting the words "less than," to clearly distinguish application of 4.42 percent discounts to voltages "less than" 34,500, from application of 7.5 percent discounts to voltages 34,500 or higher); and LEG has withdrawn its second modification. **Thus, the LGS tariff issues seem to be resolved. The Board should confirm that it expects IPL to amend the wording of the eligibility requirement for the 4.42 percent primary service discount, from "4,160 to 34,500 volt service" to "4,160 to <u>less than</u> 34,500 volt service," in its LGS compliance tariff.**

Bulk Power Service Tariff Changes

<u>IPL Initial</u>

Initial Brief: pp. 126-127

LEG proposes a clarifying wording modification to the customer applicability section of Bulk Power Tariff Sheet No 29. IPL accepts the proposed modification. (Tr. 794).

<u>Consumer Advocate Initial</u>

Initial Brief: p. 109

Consumer Advocate does not dispute IPL's proposed rate design changes.

<u>ICC Initial</u>

Initial Brief: p. 64

IPL's tariff and rate design proposals for the Bulk Power class are generally appropriate, except for creation of the Regional Transmission Service (RTS) rider.

[61] First, IPL proposes to change the power factor provisions by adding a new condition that the customer's power factor will be regarded as 100 percent if the customer is providing kiloVARs to IPL at the time the customer's billing demand is determined. Second, IPL proposes changes to the primary service discount provisions to reflect the sale of IPL's transmission system to IPC-Midwest. The discounts will now apply without qualification, provided the customer assumes all responsibility for transforming voltage from the transmission level.

LEG Initial

Initial Brief: pp. 22-24

IPL proposes several changes to its Bulk Power tariff. LEG proposes adding a clarifying modification, inserting the words "of 34.5 kV" into the phrase "transmission voltage level or above," changing it to "transmission voltage of 34.5 kV or above."[62] (Tr. 1379).

Staff Analysis

IPL proposes five changes to its Bulk Power tariff.[63] **None of the parties oppose any of these Bulk Power tariff changes**.

IPL accepts LEG's proposed wording modification. (Tr. 794). **Thus, the Bulk Power tariff issue seems to be resolved. For clarity, the Board should confirm that it expects IPL to amend the wording of the first sentence of the "Applicable" section of its Bulk Power compliance tariff to read as follows:**

> Available only for bulk transmission voltage level supply at transmission voltage of 34.5 kV or above.

Standby and Supplementary Power Service (SSPS) Changes

IPL Initial

Initial Brief: pp. 128-32

ICC proposes to drastically reduce transmission reservation charges for standby customers. ICC contends that the same approach used to develop standby reservation charges for generation should be used for standby transmission

[62] Following the sale of IPL's transmission system to ITC-Midwest, transmission voltage is defined as 34.5 kV and above.

[63] First, Bulk Power service will be un-frozen and made available to all LGS customers who might be eligible. IPL analysis indicates three LGS customers will likely transfer to Bulk Power service, which is reflected by transferring their LGS billing determinants and revenues to the Bulk Power class. Second, the specific service voltage conditions will be replaced with the simple condition that customers must take service at transmission voltage (i.e., must not use any of IPL's distribution system). Third, Bulk Power customers will be eligible for Interruptible Service (as LGS customers are currently). Fourth, the previously frozen Bulk Power standby service provision will be deleted. No Bulk Power customer currently uses this provision, which means both new and current LGS and Bulk Power customers will continue to use Rider SSPS (Standby and Supplementary Power Service), which applies to all pricing zones. The fifth change is to double the current reactive demand charge from $0.61 to $1.22 per kiloVAR (similar to the change proposed in Rider SSPS), to provide an appropriate price signal for LGS customers transferring to Bulk Power. IPL states the change will have negligible billing impacts.

reservation charges. (Tr. 1307). IPL disagrees. There are significant differences between the costs a utility incurs for standby generation versus standby transmission. Given that there is a liquid market to purchase generation, IPL does not have to build its generation portfolio to serve its standby customers' entire contracted load, and can consider factors such as outage rates and diversity. However, unlike generation, IPL must ensure the transmission system is designed to accommodate the contract demands of standby customers, which can occur at any time. Further, ITC-Midwest's future investment decisions regarding the transmission system will be based, in part, on standby contract demands. Allowing standby customers to pay less than full transmission rates would result in subsidization between retail and standby customers. (Tr. 797).

IPL's methodology for calculating its standby transmission reservation charge has been consistently used in a number of dockets since 2003.[64] ICC has been a party to each of these dockets and has never challenged the IPL methodology until now. (Tr. 798).

Accepting ICC's proposal would cause a substantial reduction in transmission revenues from standby customers. For example, assuming no increase in IPL's cost of transmission, the existing transmission reservation charge would be reduced from $2.14 per contract kW demand to approximately $0.11 per contract kW demand, causing standby transmission revenues to decrease from $3,852,000 to $192,600. (Tr. 799). This $3.7 million cost shift would have to be borne by IPL's other retail customers.

IPL also notes that ICC's proposal would not result in a reduction in the transmission expenses incurred by IPL. ITC-Midwest's revenue requirement would not change as a result of ICC's proposal since the revenue requirement reflects the full capacity requirements of standby reservation. ICC is attempting to confuse the issue of how ITC-Midwest charges IPL for the use of its transmission system versus the investment required to build and maintain a reliable transmission system. The transmission capacity is continuously available whether or not it is utilized by the standby customers; and the transmission service "stands by" to meet the immediate needs of these customers. The transmission system must not only meet the instantaneous

[64] IPL first proposed a standby reservation charge for transmission capacity when it initially filed its Pre-scheduled Energy Only Standby Service for Board approval on May 28, 2003, and as amended on November 14, 2003 (Board Docket Nos. TF-03-164 and TF-03-176). The standby reservation charges were referred to as "System Access Charges" in these filings. The methodology for determining the transmission reservation charge was based on the transmission revenue requirement for the Large General Service (LGS) customer class divided by the total kW demand billing determinants for that class. (Tr. 797-98). The Board approved this tariff in its order issued December 5, 2003. IPL followed the same methodology for deriving the transmission reservation charge in Docket No. RPU-04-1. Finally, this methodology is reflected in "Reservation Fees for Reservation of Transmission Service" in the Standby and Supplementary Power Service (SSPS) tariff in Docket No. TF-06-336, approved by the Board in its order issued September 27, 2007.

needs of IPL's full requirements customers, but also provide for the reservation contract demands of its standby customers. (Tr. 799-800).

The fallacy of ICC's concept of transmission reserves imploded upon cross-examination at the hearing (Tr. 1345-47):

Q. (Mr. Ragsdale) I believe my recollection of your discussion with her [Board Member Tanner] is you equated the design of the transmission system with the generation system for the purposes of the standby rate?

A. (Mr. Brubaker) I believe I indicated that there were reserves in the transmission system just like in the generation system.

Q. You'd agree with me, wouldn't you, that in a normal utility that provides electricity, they have a number of different types of power plants, generating plants?

A. Yes.

Q. Some of those are peaking facilities, some of them are base load, some of them are intermediate?

A. Correct.

Q. And they also have other resources or reserves they can call upon to serve their customers, including purchased power from other utilities; is that correct?

A. At times, yes.

Q. What type of a transmission facility would you regard as a peaking transmission facility?

A. Transmission facilities don't fall in the same categories, but the transmission network often has a variety of ways for power to move from a generation source to a load. It's unusual, particularly for high voltage, that you have just one way in. Particularly for the larger customers, there's generally or many times loop lines and access from various points to the load.

Q. Now, with those peaking facilities, intermediate facilities we talked about earlier on the generation system, they don't run all the time, do they?

A. They run when they need to run, so it's not all the time.

Q. And they have variable costs in their operations; isn't that correct?

A. Yes.

Q. That would be like fuel costs, maintenance costs associated with running those facilities?

A. Yes.

Q. A transmission system doesn't have really comparable costs now, does it?

A. No. Very minimal.

Q. Were you here yesterday when Mr. Bauer responded to the Board's questions on this issue?

A. I was not.

ICC's proposal created confusion surrounding the difference between the costs associated with the design of a transmission system and the billing units upon which those costs are recovered. It is true that the billing units IPL incurs from ITC-Midwest are based on actual peak loads. However, this is clearly different than the assumptions used to design and build the system. As IPL witness Bauer testified, ITC-Midwest uses scenarios in which the contracted loads from standby customers are used to design and build the system. (Tr. 829-34). Therefore, this standby capacity is part of what causes the costs of transmission and should be borne by those customers on standby service.

Clearly, the operations and cost profile of a transmission system differ significantly from a fleet of generation resources. As a result, the cost that standby customers place on the transmission system is markedly different than the cost such customers place on a generation portfolio. When the transmission system is used, the whole system is used. There are no peaking transmission resources.

For the reasons outlined above, there is no support for the methodology proposed by ICC; and it would only result in a substantial shift in transmission cost responsibility to IPL's full requirement customers.

Consumer Advocate Initial

Initial Brief: p. 109

Consumer Advocate does not dispute IPL's proposed rate design changes.

ICC Initial

Initial Brief: pp. 64-68

IPL's proposed monthly reservation charge for standby transmission service – an increase from $2.14 per kW to $3.95 per kW – substantially overstates the cost of providing the service. This is equal to the full transmission demand charge that IPL would pay ITC-Midwest if a standby customer imposed its full load during every monthly peak, and represents an 85 percent increase over current rates. This large increase in rates lacks any meaningful rationale. IPL's method gives no consideration to the reliability of the customer's generation for which standby service is being provided, nor does it account for the probability of the standby customer's load imposing transmission costs on IPL. This is simply contrary to how electric utilities typically plan and manage their transmission systems. (Tr. 1342-43). As a result, IPL's proposal would substantially overcharge customers.[65] (Tr. 1304).

IPL witness Bauer claims that IPL provides ITC-Midwest information about IPL's contract demand levels (including its standby reservation levels), which are included in ITC Midwest's transmission system planning. (Tr. 835-36). The implication is that ITC-Midwest plans and constructs its transmission system as if it were serving IPL's standby customers continuously at full contract demand levels, and that ITC-Midwest's costs reflect this. This is simply not realistic. (Tr. 1342-43). In any event, IPL's standby transmission customers should not be held responsible for any "gold plating" of the transmission system undertaken by ITC-Midwest. Also, importantly, ITC-Midwest does not bill IPL for standby transmission expense based on standby contract demand levels. Rather, the billings are based on actual monthly peak loads, when the standby customers may or may not be on the system. (Tr. 827-28, 831).

In contrast to IPL's proposal for its standby transmission reservation charge, ICC offers a reasonable proposal that properly reflects the reliability of the customer's generation and the probability that the customer will cause transmission costs to be incurred. Specifically, ICC proposes that the reservation charge for standby transmission service should be determined using the same general approach that applies to the reservation charge for standby generation service.

The reservation charge for standby generation service is less than the demand charge for full-requirements supplementary service because IPL serves standby load only a small percentage of the time that it provides full-requirements generation service. The supplementary generation service customer is charged

[65] IPL downplays the significance of the size of the increase by simply asserting that the level of increase is the same as for the LGS and Bulk Power classes. (Tr. 819).

a rate that approximates full cost recovery based on the customer's maximum demand. However, when a customer takes standby service, the imposition of demand on IPL's system is only occasional (due to the reliability of the customer's generation, the scheduling of maintenance outages, and the resulting limited need for service from IPL). Thus, the standby generation charge is correspondingly much less than the full-requirements charge.

IPL's standby transmission reservation charge should be designed similar to its standby generation charge. Like standby generation customers, standby transmission customers utilize the utility system only occasionally, through scheduled maintenance or unanticipated forced outages. The standby generation reservation charge recognizes this by charging only about 5 percent of the full generation demand component charged to full requirements customers. (Tr. 1304).

However, instead of 5 percent, IPL proposes to charge 100 percent for the standby transmission reservation charge. (Tr. 1288). IPL should instead charge a standby transmission reservation charge that is 5 percent of the monthly transmission demand charge, plus a daily transmission usage fee that is 1/30th of the monthly transmission charge. This would make the standby transmission charges similar to those for standby generation. (Tr. 1288).

An alternative approach would be to impose no standby reservation charge for transmission service at all, because these costs are incurred by IPL only to the extent that loads are actually placed on the system at the time of monthly peak. Under this approach, standby customers would pay IPL's 100 percent standby transmission reservation charge only to the extent they impose demand at the time of monthly system peak; otherwise, they would pay no reservation charge. This approach would fairly compensate IPL for what it pays ITC-Midwest, and is consistent with the transmission costs that the standby customer actually incurs. (Tr. 1308).

LEG Initial

Initial Brief: pp. 27-29

LEG concurs with ICC's recommendations regarding standby transmission reservation charges, and with its rationale underlying those recommendations. (Tr. 1392-93).

ICC Reply

Reply Brief: pp. 24-26

IPL has failed to justify its 85 percent increase in transmission reservation charges for standby customers. In its initial brief, IPL argues that its generation reservation charges are determined on a different basis than its transmission reservation charges, given that there is a liquid market to purchase generation. But this argument fails to recognize that the rationale for designing standby reservation charges (for both generation and transmission) long pre-dates the development of a "liquid market" for generation. The emergence of MISO and organized wholesale generation markets have nothing to do with the reliability of standby customer-owned generation, or the probability of standby customers using the transmission system during peak times. (Tr. 1319).

Nothing in the record demonstrates IPL's suggestion that ITC-Midwest's transmission system is designed to serve 100 percent of standby customer load. IPL claims that it provides ITC-Midwest the contract demand levels of its standby customers, and makes the unrealistic assertion that ITC-Midwest plans the transmission system as if the full level of that contract demand was using the system at the time of monthly system peak. But the testimony offered by IPL does not support the claim that ITC-Midwest invests and incurs costs on that basis. In fact, utilities factor in the reliability of customer-owned generation and the probability of standby customers being on the system at the time of system peak. (Tr. 1341-43). IPL witnesses Vognsen and Bauer offer no credible testimony to contradict ICC witness Brubaker's testimony on this issue.[66] Instead, IPL ignores this reality and makes an unsupported leap in concluding that costs are incurred based on full standby contract demand levels. IPL's position should be rejected by the Board so that standby customers pay a transmission reservation charge that is consistent with the costs they impose on the system.

Staff Analysis

IPL is proposing to increase its monthly charge for standby transmission reservation service, from $2.14 to $3.95 per kW, corresponding to IPL's increased transmission service costs from ITC-Midwest. **ICC and LEG object to the increase, and believe the transmission reservation charge should be reduced to 5 percent of its proposed level (i.e., reduced to about $0.1975 per kW)**.[67] **No one objects to any of IPL's other proposed tariff changes**.[68]

[66] Mr. Bauer asserted that the reliability of customer-owned generation is not relevant, and that "[i]f you have a 00.1 percent probability it's going to happen, it still has a potential to happen, and you have to provide service for that hour." (Tr. 835-36). Mr. Bauer apparently does not give any consideration to transmission reserves, or the looped or networked nature of the transmission system providing multiple paths to reach larger standby customers. (Tr. 1345-46).

[67] ICC and LEG also propose a daily transmission usage fee that is 1/30th of the monthly transmission charge.

[68] IPL proposes to eliminate the frozen Pre-Scheduled Energy Only Standby tariff, which means all LGS and Bulk Power customers would take standby service under Rider SSPS. Under Rider

The focus of the issue regarding IPL's standby transmission reservation charge seems to be whether the ITC-Midwest transmission system serving IPL is designed to accommodate the full combined contract demands of IPL's standby transmission customers. IPL contends that ITC-Midwest plans its system this way. ICC argues that it does not, and that IPL has not presented evidence demonstrating that it does. However, IPL witness Bauer describes the ITC-Midwest planning process as including the contract demands of standby customers, to ensure that ITC-Midwest has adequate facilities to serve 100 percent of IPL's potential load at time of system peak, regardless of the likelihood of that load occurring; and that this capability is built into the cost structure of providing transmission service to IPL. (Tr. 833-86). In contrast, ICC's assertions about ITC-Midwest system planning seem based on general observations rather than specific knowledge about the ITC-Midwest system or its planning practices. (Tr. 1334-42).

How ITC-Midwest plans its system is important because it reflects how the system is ultimately built, which determines the ITC-Midwest revenue requirement. ICC makes much of the fact that IPL is billed according to its actual monthly demand, rather than its maximum potential demand. However, ITC-Midwest's billing is not necessarily related to how its revenue requirement is determined; and how IPL is billed externally does not necessarily determine how it should allocate its billing costs internally.

If ITC-Midwest planning and the resulting revenue requirement are based on maximum potential demand, (including the contract demands of IPL's standby transmission customers), it suggests the standby customers should pay the costs incurred to serve them. Although ICC does not believe that ITC-Midwest plans its system to include the full contract demands of IPL's standby transmission customers, ICC agrees that standby customers should pay for whatever costs are incurred to serve them. (Tr. 1337-38).

Staff recommends the Board approve IPL's proposed increase in its monthly charge for standby transmission reservation service, corresponding to IPL's transmission service costs from ITC-Midwest. Staff finds IPL's specific testimony regarding ITC-Midwest's planning process (Tr. 829-43) more persuasive than ICC's more general testimony (Tr. 1334-47). A broader question might be whether ITC-Midwest's transmission planning process accounts for standby transmission demand correctly. But this is more of an engineering question, which seems beyond the scope of this issue.

SSPS, Bulk Power access to supplementary service will be unfrozen, and proposed changes in standby and supplementary service rates and tariff language are mostly consistent with rate and tariff language changes in the LGS and Bulk Power tariffs. IPL also proposes a doubling of the reactive demand charge from $0.61 to $1.22 per kiloVAR (similar to the change proposed in the Bulk Power tariff).

Staff also recommends the Board approve IPL's other proposed SSPS and standby tariff changes (uncontested), corresponding to IPL's final approved revenue requirement as applicable.

Other Uncontested Changes

General Service Tariff Changes. IPL proposes two changes. First, for new customers requesting 3-phase service, IPL proposes to assess an additional monthly customer charge of $45, instead of the current practice of assessing a $45 excess facilities charge for the additional transformation needed to provide 3-phase service. This change will not apply to existing 3-phase customers. The change in policy is intended to make the $45 charge more understandable to customers and to streamline tariff administration. Second, IPL proposes to eliminate the minimum kVA billing demand provision for 3-phase farm customers served under Rate 820. This change will have no detrimental impact on customers. (Tr. 769-70).

Interruptible Service Tariff Changes. IPL proposes several changes. First, IPL proposes to eliminate the monthly $80.92 administration and dispatching charge that applies only to interruptible customers in the IPC pricing zone. Since interruptible customers are jointly dispatched and administered, there is no cost justification for this separate charge. The second and third changes would eliminate separate provisions for applying primary service discounts and determining billing demands for IPC zone customers. These changes are reflected in the test year billing determinants. IPL states that most of the affected customers will benefit from these changes. IPL further states that only two customers will be negatively impacted and these customers can reasonably mitigate the impacts by reducing their summer billing demands. (Tr. 771-74, Ex. DV-1, Sch. F).

Day Ahead Hourly Pricing (DAHP) Changes. Consistent with what was done in IPL's last rate case (Docket No. RPU-05-3), the customer baseline usage will be recalibrated to reflect usage during the 2008 test year. (Tr. 777).